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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

Nos. 73-437, *et al.*

MOBIL OIL CORPORATION, *et al.*,
Petitioners,

v.

FEDERAL POWER COMMISSION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR PETITIONER MOBIL OIL CORPORATION

OPINIONS BELOW

The opinion of the Court of Appeals (App. C to Pet., pp. 5-61)[1] and its opinion denying rehearing (App. B

[1] Appendices to the Petition were printed separately; include the judgment below, opinions below, and pertinent sections of the Natural Gas Act; and are cited in this Brief by reference to that volume (*e.g.*, App. A to Pet., pp. 1-3). The Appendix to this Brief consists of five additional volumes that served as the Joint Appendix below and which are cited by reference to the volume number and appendix page therein (*e.g.*, I A. 1-2). With this five volume Appendix, Petitioners have filed an additional volume, designated Volume IA, which includes a Master Index to the Appendices to the

to Pet., pp. 3-4) are reported at 483 F.2d 880. The opinions and orders of the Federal Power Commission (II A. 559-668, II A. 865-885) are reported at 46 FPC 86 and 46 FPC 633.

JURISDICTION

The judgment of the Court of Appeals was entered on April 16, 1973 (App. A to Pet., pp. 1-2). Timely petition for rehearing was denied on June 11, 1973 (App. B to Pet., pp. 3-4). The petition for writ of certiorari in No. 73-437 was filed on September 6, 1973 and was granted on January 14, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

STATUTES INVOLVED

Sections 4, 5, and 19(b) of the Natural Gas Act, 52 Stat. 821, 822, 831, as amended, 15 U.S.C. §§ 717c, 717d, 717r, are involved and are reproduced in the Appendices to the Petition (App. D to Pet., pp. 65-69).

QUESTIONS PRESENTED

In proceedings under Sections 4 and 5 of the Natural Gas Act to fix maximum rates for producers' sales of natural gas in the onshore and offshore Southern Louisiana area, which provides approximately 33% of national supply, the Federal Power Commission adopted an opposed "settlement" providing (1) a formula for "forgiveness" of refunds of approximately $150,000,000 owed primarily by a few area producers, (2) a structure of maximum area rates for "flowing" and "new

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Petition and to the principal contents of Volumes I through V of the Appendix and the excerpts from the pertinent Docket Entries below.

gas" tied to this "refund-forgiveness" formula, (3) "moratoria" on rate increases extending to 1976 and 1977, (4) mandatory minimum charges by pipelines to producers for transportation of liquids and liquefiable hydrocarbons, and (5) no allowances for producers' royalty payments calculated on bases of "market value" and other "values" exceeding the Commission-prescribed area rates. The Court of Appeals affirmed, and questions presented are:

1. Whether standards of Sections 4 and 5 of the Natural Gas Act prohibiting unduly discriminatory, unduly preferential, and unreasonable rates are violated by a "refund credit" formula which *inter alia*

(1) favors a few preferred area natural gas producers who have collected the highest rates above Commission-prescribed "just and reasonable" rates,

(2) provides additional working capital for such preferred producers,

(3) imposes maximum rates on all other natural gas producers without providing comparable working capital allowances, and

(4) requires all other producers to "earn" rate escalations available to the few preferred producers so favored by the "refund credit" formula by committing new natural gas reserves while new natural gas reserves of the preferred producers are counted only to discharge refund liabilities, and not toward earning the escalations.

2. Whether maximum rates imposed on natural gas producers who do not receive additional compensation under the "refund credit" formula provide an adequate rate of return, allowances for exploration and development, and coverage of revenue requirements consistent with the "just and reasonable" standards of Sections 4 and 5 of the Natural Gas Act, the "end result" test of

Federal Power Commission v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), and the "area rate" test of *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

3. Whether "moratoria" on access to rate changes under Section 4 of the Natural Gas Act, extending to October 1, 1976 for one class of producers' sales and to October 1, 1977 for another class of producers' sales, are unjust, unreasonable and unsupported by required findings of fact and by substantial evidence as to projections of future stability of costs, impact of inflation, and increasing costs and revenue requirements.

4. Whether mandatory "minimum charges" by natural gas pipeline companies to natural gas producers for transportation of liquefiable hydrocarbons and liquids are unjust and unreasonable, are supported by required findings of fact upon substantial evidence, and otherwise were adopted in accordance with limitations on the scope of the proceeding to fix area rates for Southern Louisiana producers.

5. Whether in determining revenue requirements and area rates, the Commission unlawfully failed to allow for, or provide procedures for adjustment for, royalty payments by producers that must be computed on "market value" and other "values" exceeding the levels of producers' rates which are prescribed or allowed by the Commission under the Natural Gas Act.

STATEMENT

1. *Prior History of Southern Louisiana Area Rates.* Mobil is an "independent producer" of natural gas regulated by the Commission since June 7, 1954, and is a substantial seller of natural gas in the Southern Louisiana Area.[2] Prior history of proceedings to fix rates for

[2] For purposes of fixing producers' area rates, the Commission includes in this Area that portion of the State of Louisiana lying

producers in this area is set forth in *Southern Louisiana Area Rate Cases (Austral Oil Co.* v. *FPC)*, 428 F.2d 407 (5th Cir.), *cert. den.* 400 U.S. 950 (1970) (the *Austral* case), and is summarized in the Commission opinions on review (II A. 582-588).

Unlike other Petitioners here, Mobil raises no questions as to these prior decisions in the first Southern Louisiana area rate case. Questions presented by Mobil arise from the second such case initiated by the Commission in 1969. The first two questions involving the "refund-forgiveness" formula and related maximum area rate levels arose in this second case and present conflicts between the holdings below and those in *Texas Gulf Coast Area Natural Gas Rate Cases (Public Service Commission for the State of New York* v. *Federal Power Commission, et al.)*, 487 F.2d 1043 (D.C. Cir. 1973), pets. for writs pending *sub nom.*, Shell Oil Company v. Public Service Commission for the State of New York, Nos. 73-966, *et al.*[3] The other three questions presented by Mobil involve specific provisions of the area rate structures prescribed in the second Southern Louisiana area rate proceeding and in other Commission area rate cases since 1969.

2. *Proceedings before the Commission.* By order issued March 29, 1969, the Commission initiated proceedings in Docket No. AR69-1 under Sections 4 and 5 of the Act to consider modifying certain of the rates for natural gas producers in Southern Louisiana fixed in 1968 by the opinions reviewed in *Austral* (I A. 2-11). Subsequent orders expanded the scope of the proceeding

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south of the 31° parallel, including both State and Federal domains offshore Louisiana in the Gulf of Mexico. *Southern Louisiana Area Rate Proceeding*, 25 FPC 942 (1961).

[3] Forty copies of the then unreported opinion by the District of Columbia Circuit were filed on September 6, 1973 as a Supplement to Appendices to the Petition in this case.

and provided for reconsideration of all Southern Louisiana area rates, the refund liabilities under the opinions reviewed in *Austral*, and refund liabilities accruing since issuance of the opinions reviewed in *Austral* (I A. 73-85, I A. 360-361).

From the outset, the proceedings were conducted as a formal adversary hearing before a Hearing Examiner under Sections 4 and 5 of the Natural Gas Act and the Administrative Procedure Act, 5 U.S.C. §§ 556 and 557 (see I A. 2, 9, 79). Commencing on July 8, 1969, a series of prehearing conferences were held to narrow issues, develop stipulations and questionnaires, and agree upon other matters to expedite the formal hearings (*e.g.*, I A. 1). Formal hearings commenced on May 26, 1970, and with various recesses, continued until March 11, 1971 (I A. 365).

At the formal hearings, a broad range of evidence was submitted on economic and supply issues, including presentations by a producer group in which Mobil participated, a group of intervening distribution companies styled the United Distribution Companies (UDC), other such groups styled Associated Gas Distributors (AGD), Municipal Distributors Group (MDG), the Pipeline Purchasers Group, and the Commission's Staff. More detailed references are made to specific parts of these presentations in discussion of issues raised by Mobil, *infra*.

While the formal hearings continued, on April 1, 1970, at the request of certain parties, the Examiner convened a settlement conference pursuant to Section 1.18(e) of the Commission's Rules of Practice and Procedure (I A. 92-93). While the formal hearing continued on the record, various sessions of this conference were held off the record between April 1, 1970 and November 6, 1970.

On November 6, 1970, the distribution companies styled UDC filed a motion for "promulgation" of a settle-

ment proposal that had been developed by representatives of distributors, the Pipeline Purchaser Group, and certain producers (II A. 669-702). UDC alleged that a proposal appended to its motion had "the support of most, but not all, of the other parties participating in such conferences" (II A. 671-672). On November 9, 1970, the Commission issued notice of the filing of this proposal, providing thirty days for responses or other pleadings objecting to or supporting this proposal (I A. 139).

Responsive to the UDC Motion, endorsements of the UDC proposal were filed by the Pipeline Purchasers (I A. 111-113), AGD (I A. 136-138), various state commissions, the Commission's Staff (I A. 130-132), and numerous producers (I A. 114-119). Certain other producers endorsed the proposal but with express reservations as to expressions therein concerning its efficacy to increase the supply of natural gas in Southern Louisiana. Such "reservations" were expressed on behalf of Continental Oil Company; Superior Oil Company; Texaco Inc.; Bradco Oil & Gas Co. and Bradco Properties, Inc.; E. Cockrell, Jr.; U.S. Oil of Louisiana, Inc., *et al.*; Placid Oil Company and 14 other producing entities; and Skelly Oil Company (see I A. 120-129, I A. 133-135, I A. 146-151, I A. 206-207, I A. 218-220, I A. 241-255).

In addition, pleadings opposing the proposal were filed by Mobil (I A. 155-205); Amoco Production Company (I A. 289-309); Memphis Light, Gas and Water Division (I A. 223-240); Public Service Commission of the State of New York (I A. 256-277); American Public Power Association (I A. 279-288); American Public Gas Association and the Consumer Federation of America (I A. 317-338). On widely varying substantive grounds, discussed *infra*, these parties sought either substantial modification of the UDC proposal, or rejection of that proposal and adoption of alternatives, or termination of the settlement conference and decisions by the Hearing

Examiner and by the Commission upon the record then being developed before the Hearing Examiner.

By order issued December 24, 1970, the Commission made the UDC proposal a part of the "the record" in its entirety; but the answers and objections thereto and alternative proposals, such as that presented by Mobil, were not so made a part of "the record" (I A. 352-354). Instead, the Commission provided that evidence as to objections to the UDC proposal should be presented in the proceedings before the Examiner (I A. 354, 363-364).

In pertinent part,[4] the UDC proposal provided:

(1) Area ceiling rates (in cents per thousand cubic feet (Mcf) at 15.025 psia):

For contracts dated *prior to* October 1, 1968:

Onshore 22.375 cents per Mcf
Offshore 21.375 cents per Mcf

For contracts dated *on or after* October 1, 1968:

Onshore 26.0 cents per Mcf
Offshore 26.0 cents per Mcf

(2) Fixed escalations in the area ceiling rates:

For contracts dated *prior to* October 1, 1968:

0.5 cents per Mcf on October 1, 1973

For contracts dated *on and after* October 1, 1968:
1.0 cents per Mcf on October 1, 1974

(3) Contingent escalations in area ceiling rates:

For contracts dated *prior to* October 1, 1968:

0.5 cents per Mcf *if*, prior to October 1, 1977, new reserves of natural gas dedicated in South-

[4] The UDC proposal was reproduced in its entirety as Appendix A to Commission Opinion No. 598 (I A. 675-702).

ern Louisiana to the interstate market by the producing industry as a whole total 7.5 trillion cubic feet; an additional 0.5 cents per Mcf *if*, prior to October 1, 1977, such natural reserve additions total 11.25 trillion cubic feet; and an additional 0.5 cents per Mcf *if*, prior to October 1, 1977, such natural gas reserve additions total 15 trillion cubic feet; but *excluding* from such reserve additions, all reserve additions used to obtain discharge of refund liabilities;

(4) Moratoria on Increases above ceiling rates:

For contracts dated *prior to* October 1, 1968:

until October 1, 1976

For contracts dated *on or after* October 1, 1968:

until October 1, 1977

(5) Refunds of Amounts Collected Above Just and Reasonable Rates:

A total refundable amount of $150,000,000 computed by application of a formula set out in Sections 3 and 8 of the proposal (discussed in more detail, *infra*), but with provisions that (1) any producer owing refunds may be relieved thereof by a credit of 1.0 cents for each Mcf of new natural gas reserves committed to the interstate market in Southern Louisiana, and (2) any such reserves so "used" cannot be counted in computing reserves to earn the contingent escalations in ceiling rates for all area producers, referred to *supra*.

(6) Transportation Charges by Pipelines to Producers:[5]

[5] These charges were proposed to be applicable to contracts dated prior to the effective date of the Commission's order covered by certificates previously issued under Section 7 of the Natural Gas Act but which had been conditioned to outcome of a pending rule-

> Mandatory "minimum" charges to be made by pipeline companies to producers for transportation of liquids and liquefiable hydrocarbons computed on the basis of:
>
> > Two-hundredths of a cent (.02 cents) per Mcf per mile for liquefiable hydrocarbons and related fuel; and Twenty cents (20 cents) per barrel for liquid hydrocarbons.

Other provisions covered definitions of certain sales, a system for reporting dedication of new natural gas reserves under the contingent escalation and "refund forgiveness" provisions, quality standards and delivery points, and applicability to pending certificate applications and other dockets involving refund liabilities.

Thereafter, in the proceedings on the formal record before the Hearing Examiner, evidence concerning rates, rate design, area rate structure, and impact and opposition to the "settlement" proposal was served on January 15, 1971, February 16, 1971, and March 3, 1971. Hearings for cross-examination of this phase of the evidence continued until the record closed on March 11, 1971.

No witness appeared to sponsor or otherwise explain the rationale or substance of the UDC "settlement" proposal which had already been made a part of the record simply by Commission order (I A. 352-354). UDC presented one witness sponsoring statistical data showing mechanical application of the proposal to refunds due by producers, area sales volumes, and past and projected revenues for individual producers (IV A. 706-722; Exs. 90-93, incl., V A. 233e-241e). These exhibits also permitted comparison of revenues assumed under the UDC

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making proceeding in which such charges already were in issue, and to all contracts dated after the effective date of the Commission's order in the instant case.

proposal with composite cost figures presented by other witnesses (Ex. 93, V A. 241e).

The Pipeline Purchaser Group presented two witnesses in support of their proposed mandatory minimum transportation charges by pipelines to producers for transportation of liquefiable hydrocarbons and liquids (Anderson, IV A. 605-608; Ex. 85, V A. 232e; Moye, IV A. 609-617).

The Commission's Staff presented one witness with a completely separate, alternative rate design presentation (Engel, IV A. 674-699). This witness endorsed the UDC proposal as "reasonable" (IV A. 699), but testified on cross-examination that he had not "appraised" whether the provisions as to waiver of producer refunds was discriminatory (IV A. 768, 772-773); had not studied or considered the pleadings opposing the UDC proposal (IV A. 774-775); and otherwise was not familiar with its specific provisions, impact upon and among producers, or the possible operation of its terms (IV A. 777-782).

The Municipal Distributor Group, opposing change of the opinions reviewed in *Austral*, presented opposition to the UDC proposal and their own alternative recommendations (Wiskup, IV A. 758-762). The witness for this Group expressed conclusions that the UDC proposal, *inter alia*, was discriminatory in favor of natural gas producers owing the largest refunds under the opinions reviewed in *Austral* and was "anticompetitive" (IV A. 760-762).

Mobil presented testimony and exhibits as to Mobil's grounds for opposition to the UDC proposal, and Mobil presented alternative proposed area rates and rate design (Knapp, IV A. 723-757; Exs. 96-99, V A. 242e-253e). By reference to evidence already in the record and to exhibits sponsored by him, the witness testified, *inter alia*, that (1) the ceiling rates proposed by UDC were

below producers' revenue requirements; (2) provisions such as the moratoria on rate increase filings and the pipelines' proposed mandatory minimum transportation charges were unsupported and excessive; (3) the provisions for treatment of producer refund liabilities and future contingent escalation of ceiling rates were discriminatory in favor of a few preferred producers who collected the highest rates in excess of the just and reasonable rates in the past and owed most of the refunds, and against producers who had made refunds in the past, charged lower rates, and generally followed Commission area rate guidelines;[6] and (4) the proposals for treatment of producer refunds and related terms of the proposal were anticompetitive (IV A. 723-757; 815-820). Mobil thus showed that in operation and effect, the UDC scheme would:

(1) permit the preferred sellers who had collected amounts at rates in excess of just and reasonable rates an added bonus above flowing gas rates prescribed for the past and for the future;

(2) make available, on a preferential basis, substantial amounts of additional working capital to be used by these preferred sellers in competitive lease bidding in the Southern Louisiana area and for other unrestricted corporate purposes;

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[6] See *Statement of General Policy No. 61-1*, 24 FPC 818 (1960); *Fourth Amendment to Statement of General Policy No. 61-1*, 26 FPC 661 (1961); *Socony Mobil Oil Co., Inc.*, 31 FPC 1101 (1964). The exhibits cited showed that of the $150,000,000 of refunds computed under the UDC proposal, only a few producers owed most of these amounts (Ex. 104, Sched. 91-5, Sheet 2 of 2, set forth at V A. 268e), *e.g.*:

Shell Oil Company	$14,700,000
Standard Oil Company of California	$19,200,000
The Superior Oil Company	$28,600,000

(3) provide such a special "incentive" allowance only for these preferred sellers, not made generally available to all area sellers of flowing gas;

(4) allow the same few preferred sellers the full benefit of industry-wide contingent escalations in flowing gas ceiling rates that would be earned by dedication of new natural gas reserves by *other* producers, even though the new natural gas reserves dedicated by the few preferred sellers would be counted only in reducing their own individual refund liabilities;

(5) authorize higher realization from sales from new natural gas reserves for the few preferred sellers, substantially above that made available to other sellers or new entrants under the "new gas" ceiling rate;

(6) create an anti-competitive, preferential pricing system favoring one group of existing producer sellers and discriminating against other existing producer sellers and new entrants competing for leases, reserves, and sales in the area;

(7) establish an anti-competitive pricing structure providing preference and discrimination in favor of existing natural gas buyers and against new entrants on the buyers' side competing for new natural gas reserves;

(8) force all area producer sellers, in effect, to absorb the impact of the few preferred companies' refund liabilities through lower realization from sales of flowing gas and new gas and because of the obligation to "earn" the contingent escalations in ceiling rates for "the industry," including the preferred sellers, while these few preferred sellers use their own dedications of new natural gas reserves only to discharge their individual company refund liabilities.

For these reasons, Mobil submitted an alternative "rate design" under which (1) the required working capital,

revenue allowances, and "incentives" for increased exploration and development would have been included in the "flowing gas" and "new gas" rates made available to all area natural gas producers; (2) each individual producer owing refunds would have been given the option of making such refunds in cash or of collecting reduced amounts under the new area rates until the individual company refund liabilities were thus discharged; and (3) present and future requirements for capital would have been so recognized and protected without discriminatory impact upon any class of producers or upon individual companies (IV A. 749-752, V A. 242e-247e).

After closing of the record, the Commission ordered omission of a decision by the Examiner (I A. 366-368). Briefs were filed directly with the Commission on April 15, 1971 and May 6, 1971. There was no oral argument before the Commission.

3. *The Commission Opinions.* The Commission Opinion No. 598, issued July 16, 1971, adopted the UDC "settlement" proposal without modification (II A. 559-750), a result reiterated by the Commission in subsequently denying applications for rehearing by its Opinion No. 598-A (II A. 865-885).

In Opinion No. 598, the Commission first noted review of its earlier Opinion No. 546 in *Austral* (II A. 582-587). After tracing the procedural history, the Commission concluded that its prior orders reviewed in *Austral* "now perform no office," and that the scope of its new order should extend to sales initiated both prior to and after October 1, 1968, and to the question of producer refunds (II A. 587, 588).

Turning to the UDC "settlement proposal," the Commission cited the number of parties in support and the existence of opposition and expressed its views as to its "duty" to consider a proposed settlement and that it is

"not required to have unanimous consent of all participating parties" (II A. 589-591). The Commission then summarized the principal provisions, set forth *supra*, and under the heading of "rationale" for acceptance of the proposal, stated (II A. 594):

> "It is our duty to review that record and to make findings thereon, and to come to conclusions therefrom. Only if substantial evidence supports it can we approve the settlement proposal, and this means that we must analyze supply and demand, supply-cost relationships, and costing methodology."

The Commission then referred to objections to the UDC proposal. Objections of the New York Public Service Commission and the Municipal Distributors Group were first rejected (II A. 597-599). The Commission then turned to the position of Mobil and another producer as to unlawful discrimination under the terms of the UDC proposal (II A. 599-601). The Commission noted the argument that under its provisions, producers who collected the highest rates in excess of the just and reasonable rates are favored:

> "Under the proposed settlement, as Mobil points out, one group is in effect rewarded for their relative intransigeance—they will be able to retain revenues collected up to the agreed 22.375¢ (where their contracts permit) and achieve a favored revenue position." (II A. 600, fn. omitted)

After referring to the alternative rate design proposal by Mobil, the Commission noted that Mobil's proposal provided for a higher price for new gas "coupled with a procedure for retrospective achievement of equity among Southern Louisiana producers," but concluded (II A. 600-601):

> "The logic of this position cannot be assailed. Candor requires us to admit that some of the predicted inequities as among producers will surely occur and

those who have attempted to work within the system are comparatively disadvantaged. We have chosen to go the route of the alternative rate design suggested in the UDC proposal. The inequitable consequences which might flow from it have to be compared with its advantages, and as our later sections of the Opinion will make more clear, no scheme can be free of some inequities. The broader acceptability of the UDC proposal with the distributor group impels us to act as we do."

Thus, impelled by "the distributor group," the Commission then discussed *seriatim* various categories of evidence concerning supply and demand (II A. 601-617); and supply-price relationships (II A. 617-624). Industry consequences then were reviewed, including evidence as to increased industry capital requirements; and the conclusions were stated that the instant decision would make more capital available, attract "new entrants," and "have an overall tendency to be procompetitive" (II A. 624-629).

Cost evidence was reviewed by reference to the presentations concerning "current costs" only (II A. 630-643), including a summary of each component as to which there was a dispute and a finding that a rate of return on rate base of approximately 15 percent is "just and reasonable" (I A. 635-636). Conclusions then were stated that there was "a variable range of reasonable costs of 4-5 cents per Mcf"; that the 26 cents per Mcf new gas rate in the "settlement" is "within the zone of reasonableness of costs" and "will elicit exploratory and development effort in Southern Louisiana (II A. 642) and "would be at a competitive price level with the market price for intrastate gas" (II A. 643).

Flowing gas rates (*i.e.*, gas sold under contracts dated prior to October 1, 1968) were reviewed in relation to four flowing gas cost studies "using mainly 1969 data"

(II A. 643, 644), differences in methodology, need for funds from the "realization" for flowing gas, and details of the presentation of the Commission's Staff in which a 13% rate of return on rate base was used (II A. 646-648). Nevertheless, no express findings or conclusions as to such costs were made, in terms of a "zone of reasonableness" or otherwise, although the Commission concluded the rates of 22.375 cents per Mcf onshore and 21.375 cents per Mcf offshore, as set forth in the UDC proposal, were "just and reasonable" (II A. 648).

Other provisions of the UDC proposal also were adopted:

(1) The contingent escalations of flowing gas prices tied to possible future dedications of new natural gas reserves were approved (II A. 648-649);

(2) The pipelines' mandatory minimum transportation charges to producers by pipeline companies were adopted, although the Commission recognized "certain difficulties in approving the provision" (II A. 650-651);

(3) Moratoria on producer rate increases were prescribed, without findings or other discussion, extending to October 1, 1976 for contracts dated prior to October 1, 1968, and extending to October 1, 1977, for contracts dated on or after October 1, 1968 (II A. 651-652);

(4) Producer refunds were disposed of by adoption of the "settlement" provisions for computation of refundable amounts summarized *supra*, and for future "discharge," on an individual company basis, by a "refund credit" of "one cent for each Mcf of new gas reserves" committed to the interstate market (II A. 652-654).[7]

[7] Under the UDC proposal, refunds are amounts collected by individual companies in excess of the following rates and formula (II A. 652-653, footnotes omitted):

[Footnote continued on page 18]

On another contested issue, the Commission predicated its rates on the assumptions that producers' payments to royalty owners will (1) exceed 15% of producers' total revenues, but (2) be based on the area rates prescribed in the opinions. The Commission thus treated the royalty amount as "derivative" from the 26 cents per Mcf "new gas" rate (II A. 638, 640); and in review of "flowing gas" costs, referred to studies based on 1969 costs. Mobil contested the omission of a provision to compensate producers compelled to pay natural gas royalties computed on "market values" or other bases exceeding the area rates on grounds (1) that the level of royalty payment is not subject to Commission jurisdiction or the area rate ceiling under construction of the Natural Gas Act in *Mobil Oil Corporation* v. *Federal Power Commission*, 463 F.2d 256 (D.C. Cir. 1971), *cert. den.*, 406 U.S. 976 (1972); (2) that producers are confronted with continuing and increasing claims for payments of royalties based on increased "market value" and prices far in excess of the Commission-prescribed area rates; and (3) that payments to royalty owners on these higher bases deprive producers of substantial revenues the Commission has assumed to be available to

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[7][Continued]

"(a) Prior to January 1, 1965, amounts collected above the just and reasonable rates of 20.625 cents per Mcf (onshore) and 19.625 cents per Mcf (offshore).

"(b) From January 1, 1965, to September 30, 1968, amounts collected above the just and reasonable rates of 21.25 cents per Mcf (onshore) and 20.25 cents per Mcf (offshore).

"(c) From October 1, 1968, to January 1, 1971, refunds shall be calculated by applying 30.5 percent of the difference between revenues for this period based on rates in effect prior to October 1, 1970, and the revenue which would have resulted for this period through application of rates established in Opinion Nos. 546 and 546-A, as modified by Opinion No. 567.

"(d) After January 1, 1971, refunds shall be made for amounts collected in excess of the ceiling prices established herein."

cover other costs, pay for exploration and development expenditures, and provide for return allowances. Nevertheless, the Commission made no provision to cover adjustment for reimbursement of producers for their payments to royalty owners of amounts computed on bases above 1969 levels and on the basis of "values" exceeding Commission-prescribed area rates (II A. 638, 646-647).

Other provisions of the opinion contain provisions not pertinent to questions presented here; the formal findings and ordering paragraphs incorporating provisions of the UDC proposal into the Commission's Regulations (II A. 655-661); for reporting of producer refunds due and elections to discharge liabilities under the "refund credit" formula (II A. 664-667); and for an effective date of the Commission's order of August 1, 1971 (II A. 667).

Mobil and others opposing the UDC proposal filed timely applications for rehearing as required by Section 19(a) of the Natural Gas Act, and some of those supporting UDC sought modification of Opinion No. 598 where language and terms were inconsistent with the UDC proposal (II A. 866-868). By order denoted Opinion No. 598-A, issued September 9, 1971, the Commission denied all applications for rehearing and modified its opinion in each and all respects to conform to the terms of the UDC proposal (II A. 865-885). On issues pertinent here, New York had objected to the treatment of producer refunds under the UDC proposal, and the Commission stated (II A. 870):

> "Furthermore, refunds as a part of that package represented a policy decision; if such a policy decision had not been made as it was, the price for new gas might well have been greatly higher."

The Commission further stated (II A. 875):

> "We did, in fact, accept the settlement proposal in its entirety."

Timely petitions for review under Section 19(b) of the Natural Gas Act were filed in the Courts of Appeals for the District of Columbia and Fifth Circuits by parties who had opposed the UDC "settlement" proposal. After transfer, all such petitions were consolidated and heard together in the Fifth Circuit.

4. *The Court of Appeals Opinions.* The court below affirmed the Commission's opinions in their entirety, finding Commission Opinion No. 598 "is supported by 'substantial evidence on the record as a whole'" (App. C to Pet., p. 5).

First, the court summarized prior history of producer rate regulation and traced proceedings to fix Southern Louisiana rates through *Austral* and to the present case (App. C to Pet., pp. 6-15). Propriety of use of the opposed "settlement" as the basis for decision was reviewed and affirmed (App. C to Pet., pp. 20-23). Data as to existence of a shortage of natural gas and the potential and future importance of Southern Louisiana as a supply area were reviewed (App. C to Pet., pp. 23-29). Provisions of the rate structure were treated as an interrelated "triumvirate of incentives" consisting of (1) flowing gas and new gas rates to "encourage exploration and development," (2) the formula for treatment of the recomputed $150,000,000 producer refunds, and (3) the provisions for periodic escalations in ceiling rates and for contingent escalations in the flowing gas rates dependent upon future dedications of new natural gas reserves by the industry as a whole. The court found this structure "amply supported" (App. C to Pet., pp. 30-51).

On the specific issues now raised by Mobil, the opinion is less clear as to bases for affirmance.

As to maximum ceiling rate levels, Mobil contested prescription of "flowing gas" rates on the basis of a 13% rate of return when the Commission *found* a 15%

rate of return "just and reasonable" and used 15% as a component in the rates for "new gas." However, the court's review of components of the "flowing gas" rates was not addressed to the issue of rate of return for "flowing gas" but to separate questions of the allowance for exploration and development expenses (App. C to Pet., pp. 30, 32-34), and after this discussion the "flowing gas" rates were "sustained" (App. C to Pet., p. 34).

Mobil also contested the inadequacy of allowances for exploration and development in the "new gas" rates, particularly because of deficiencies for all area producers who were not provided extra working capital by the preferential retention of refund amounts. However, until corrected on rehearing (App. B to Pet., pp. 3-4), the court considered these rates on the assumption that "no party" had contested the "new gas" rate level as too low (App. C to Pet., p. 34). The court reviewed the components of the rate as within a "zone of reasonableness" as to costs (App. C to Pet., pp. 34-39); and "sustained" the rates (App. C to Pet., p. 39).

The issues as to violation of standards of Sections 4 and 5 of the Act by the provisions for producer refunds and interrelated rate levels were noted, but were reviewed under the "substantial evidence" test (App. C pp. 45, 49, 51). The court first cited the questions

> "(ii) that the refund credit program arbitrarily and capriciously discriminates against producers, like Mobil and Amoco, who have entered into voluntary company-wide settlement agreements by which they have already made substantial refunds and reduced the rates for flowing gas in favor of relative intransigents . . . who have continued to charge rates subject to refund now found to be excessive." (App. C to Pet., p. 40).

Then, in response to arguments by New York and others, the court found the Commission "empowered" to adopt

a structure for forgiveness of producer refund liabilities (App. C to Pet, pp. 41-42).

As to specifics of this structure, the court noted that ". . . even FPC recognized that the cosmic plan which it adopted has some atomic flaws" (App. C to Pet., p. 45), but concluded that it ". . . will not reject an administrative decision merely because one producer's piece of cake is iced and another's is not" (App. C to Pet., p. 45). The court did take note of the issues raised by the unduly discriminatory, preferential, and anti-competitive impact of the UDC scheme and to the features of "industry-wide . . . benefits," but "individualized . . . in-put" (App. C to Pet., p. 46); and the effects of provisions under which ". . . Amoco, Mobil, and others who have worked within the system and made voluntary company-wide settlement agreements and substantial refunds will have to credit their new additions to the interstate market towards the target goals which trigger the contingent escalations . . ." while others ". . . will be able to reap the benefits by collecting the additional revenue for their sales of flowing gas . . ." (App. C to Pet., pp. 46-47).

In sum, however, the court treated Commission authority as purely "discretionary" and the result as not in conflict with prior decisions of this Court and of the Fifth, Ninth, and District of Columbia Circuits as to obligations of the Commission to apply producer refund formulae equitably and without undue discrimination and preference (App. C to Pet., pp. 47-49).

Provisions for future contingent escalations of the "flowing gas" ceiling rates, tied to the refund credit system, similarly also were treated solely as matters of administrative discretion and sustained "in full" (App. C to Pet., pp. 49-51).

Moratoria on access to producer rate increases under Section 4(e), extending to 1976 and 1977, were sustained

without specific reference to record evidence or impact on the "disadvantaged" producers. Instead, the court referred to the "safeguards" for the few preferred sellers under the provisions "for the retention of large amounts of capital through the refund discharge program and the periodic and contingent escalations"; alternative procedures for a "single aggrieved" producer to establish higher rates; and the court's assumption that despite the court's affirmance, the Commission will retain "power" to lift the moratoria (App. C to Pet., pp. 41-52).

The mandatory minimum charges by pipelines to producers for transportation of liquids and liquefiable hydrocarbons were sustained on the grounds that the Commission had "a substantial evidentiary basis" for these charges (App. C to Pet., p. 57).[8]

The Commission also was affirmed on other questions not raised here (App. C to Pet., pp. 53-55, 57).

Because of errors and the ommissions of express decisions upon issues squarely raised, Mobil sought rehearing. However, by its opinion issued June 11, 1973, the court denied the petition, correcting its opinion only to reflect that Mobil and another party had, in fact, sought reversal of the new gas rates (App. B to Pet., pp. 3-4).

The petitions to this Court then followed.

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[8] The court also referred to the Commission's Order No. 449 issued on January 31, 1972, establishing minimum rates for these charges on a nationwide basis. However, on July 11, 1973, the Court of Appeals for the District of Columbia Circuit reversed and remanded Order No. 449 on grounds that the Commission does not have jurisdiction to establish rates for transportation of liquids, that the rates for liquefiable hydrocarbons are the products of procedures violating rulemaking and hearing requirements of the Natural Gas Act, and that substantial evidence on the whole record did not support the rates promulgated. *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973). The opinion and judgment of the District of Columbia Circuit are now final.

SUMMARY OF ARGUMENT

These cases arise under Sections 4 and 5 of the Natural Gas Act and involve the Federal Power Commission's prescription of unjust, unduly discriminatory, and unduly preferential rates and rate structures for producers' sales of natural gas in the Southern Louisiana Area.

The rates at issue cover past periods from 1962 to 1971, apply to producers' deliveries to pipeline purchasers from 1971 to the present, and would apply to all producers' sales of natural gas subject to Commission jurisdiction in the Area until 1976. The rate structure also involves disposition of more than $150,000,000 of producers' refund liabilities under Section 4(e) of the Natural Gas Act.

Unlike other petitioners here, Mobil does not seek review of questions resolved by the first Commission Southern Louisiana Area Rate decision, Opinion No. 546, which has been set aside under the opinions in *Southern Louisiana Area Rate Cases (Austral Oil Company* v. *Federal Power Commission)*, 428 F.2d 407 (5th Cir.), *cert. den.* 400 U.S. 950 (1970). Mobil seeks reversal of specific parts of the opinion of the Court of Appeals affirming the Commission's second Southern Louisiana Area Rate decision, Commission Opinion No. 598, issued July 16, 1971. Mobil presents questions as to: (1) treatment of producers' refund liabilities and related provisions for "contingent escalation" of area rate ceiling; (2) the maximum area rate ceilings prescribed by the Commission; (3) moratoria on rate increases; (4) mandatory minimum charges to be paid by producers to pipelines for transportation of liquids and liquefiable hydrocarbons; and (5) coverage of producers' payments to royalty owners.

As shown *infra*, the opinion below presents conflicts with decisions by the Court of Appeals for the District of Columbia Circuit on the first, second, and fourth questions so raised by Mobil. On these and the remaining questions, the Commission opinion and the Court of Appeals opinion also conflict with this Court's constructions of the Natural Gas Act, particularly in *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968):

I. In its Opinion No. 598, the Commission adopted an opposed "settlement proposal" in lieu of a conventional area rate decision under Sections 4 and 5 of the Natural Gas Act and the Administrative Procedure Act, 5 U.S.C. §§ 556 and 557. Specific provisions of that "settlement" violate Sections 4 and 5 of the Natural Gas Act by imposing an unjust, unduly discriminatory, and unduly preferential rate structure.

A. By summary order of the Commission on December 24, 1970, all substantive provisions of this "settlement proposal" were made part of the record, even though hearings were still in progress before a Hearing Examiner. Thereafter, no witness available for cross-examination appeared to sponsor the major substantive provisions of the proposal, while opponents were required to present their bases for opposition through witnesses available for cross-examination. As a result, major parts of the proposal—including the choice of maximum ceiling rates, level and timing of escalations, a refund forgiveness scheme, and duration of moratoria—are in the record without evidentiary support. As a further result, these sections of the proposal have been adopted without required critical analyses under the substantive standards of the Act, without required findings of fact, and without required support in substantial evidence.

B. The refund-forgiveness provisions of the "settlement proposal" and related provisions for "contingent escalation" of area rates, set forth in Sections 3 and 8 thereof, are unjust, unduly discriminatory and preferential, anti-competitive, and violative of Sections 4 and 5 of the Natural Gas Act; and are not supported by required findings of fact based on substantial evidence. Identical provisions thus have been held unlawful in review of the Commission's Texas Gulf Coast Area rate decision in *Public Service Commission for the State of New York* v. *Federal Power Commission*, 487 F.2d 1043 (D.C. Cir. 1973).

Under the "settlement," amounts exceeding $150,000,000 which were collected in the past by producers on the basis of rates in excess of rates now determined to be "just and reasonable" would not be refunded. Producers owing these amounts could reduce their refund liability by receiving a "credit" of 1 cents per Mcf for new natural gas reserves dedicated to interstate sales, and would refund in cash only if their liabilities are not so eliminated under the refund-forgiveness formula.

Intended as an area "incentive" in the overall area rate structure, this formula actually benefits primarily a handful of producers who owe the bulk of the refunds and who have collected the highest rates in the past, and is unduly discriminatory against other producers who made refunds in the past, reduced their rates, and generally adhered to Commission "guidelines" in filing rate increases between 1960 and 1970. Among the preferential, anti-competitive effects of the formula are provisions under which

(1) the producers receiving the "refund credit" by dedicating new natural gas reserves to eliminate their own individual liabilities would also receive all escalations in "flowing gas" ceiling rates earned by "industry" dedication of new natural gas reserves by *other* producers,

but the new natural gas reserves used to so reduce individual liabilities would not be counted toward earning these "industry" escalations in ceiling rates;

(2) a "percentage reduction" would be applied to compute refunds for a past period in a way in which the producers who actually collected the highest rates in the past would be preferred over producers collecting lower rates;

(3) producers benefitted by the refund formula would receive, in effect, 27 cents per Mcf for new sales of natural gas, while producers without refund liability or new entrants in the area, would be allowed only 26 cents per Mcf; and

(4) the preferred sellers would be allowed use of the refund amounts as working capital in competitive lease bidding and other corporate activities, while other producers are not allowed comparable allowances in the revenues permitted under the area rates.

In discussing objections to this proposal, the Commission recognized that "one group is in effect rewarded for relative intransigence" and "achieve a favored revenue position"; that the "logic" of Mobil's objections "cannot be assailed"; and that "those who have attempted to work 'within the system' are comparatively disadvantaged" (II A. 600). However, the Commission stated "broader acceptability of the UDC proposal with the distributor group impels us to act as we do" (II A. 601). Yet, the very fact that the origin of this proposal was in such a private group compelled most careful scrutiny and prevention of anti-competitive, discriminatory, and preferential allowances and provisions in prescription of area rates. Commission acceptance of these formulae also is not supported by findings of fact upon evidence in the record, or by substantial evidence, and rests only upon perfunctory, conclusionary statements in-

adequate to support an area rate decision, particularly under the requirements of *Permian.*

As the District of Columbia Circuit correctly concluded in its opinion as to the Texas Gulf Coast Area, this system, and the related provisions under which the disadvantaged producers must earn escalations in area ceiling rates for these preferred sellers, cannot be rationally justified. Such patent undue preference and discrimination also violate Sections 4 and 5 of the Natural Gas Act.

Producers owing small refunds and new entrants both are adversely and unlawfully affected.

Alternative equitable, lawful procedures are available for prompt disposition of the producers refund issue consistent with the statutory standards, past Commission policy, industry capital requirements, and fairness to all Southern Louisiana area producers.

II. The area ceiling rates imposed are inadequate, and unreasonably low, are not properly supported under criteria spelled out in *Hope* and *Permian*, and do not provide "just and reasonable" rates for the producers not favored by the refund-forgiveness formula. License of an "experiment" no longer covers such patent defects in area rate decisions; the ceiling rates are lower than rates that would have been available to *all* area producers sellers but for adoption of the unduly preferential refund-forgiveness proposal to benefit a few preferred producers, and are the product of other errors:

A. A ceiling rate of 26 cents per Mcf is fixed for "new gas," *i.e.*, natural gas to be delivered under contracts dated on and after October 1, 1968. This rate could be, at best, a "bare-bones" cost-based rate, but is based upon erroneous conclusions as to the "incentive" level now required for all producers in the Southern Louisiana Area, particularly to attract natural gas for interstate markets.

The ceiling rate was picked from the "settlement" proposal without regard for substantial evidence showing that "current" costs, now and for the near-term future, are higher than 26 cents per Mcf; that a higher ceiling rate is required to meet competition for available capital; and that a higher ceiling rate is required for the *increased* exploration and development efforts called for by a critical shortage of natural gas.

The Commission acknowledged that but for its acceptance of the refund forgiveness "package," this rate would have been higher (II A. 870). Findings consistent with *Permian* simply were not made, and the "disadvantaged" producers again were ignored.

B. The Commission adopted the "settlement" proposal of 22.375 cents per Mcf "onshore" and 21.375 cents per Mcf "offshore" for "flowing gas," *i.e.*, natural gas delivered under contracts dated prior to October 1, 1968. In adopting these ceiling rates, the Commission made no findings or conclusions as to the level of costs to be covered, even on the basis of the 1969 test year, or as to producers' required revenues from this principal source of current income, which *Permian* requires.

Even though the Commission had found a rate of return on rate base of 15% to be "just and reasonable" for current cost studies, the return actually allowed under "flowing gas" rates is considerably lower and violative of controlling standards set out in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). Moreover, revenues actually allowed producers under the ceiling rates adopted will average less than average costs; average revenues would remain below 22 cents per Mcf until 1974; and neither an adequate return, area revenue requirements, nor funds required for exploration and development, are covered by these ceiling rates.

For producers who are not accorded the special extra capital funds made available through the refund-forgiveness "scheme" for those collecting the highest past rates, these "flowing gas" rates are unreasonably low.

In sum, findings prerequisite to adoption of valid area ceiling rates were not made; no adequate return allowance or cost coverage is provided in area ceiling rates allowed; and preferential allowances to a few preferred producers do not compensate for inadequate rates for all. Sections 4 and 5 of the Act thus are violated.

III. With even less attention, indicated by *only five lines* in its opinion, the Commission imposed "moratoria" on future rate increase filings by producers under Section 4 of the Act extending to October 1, 1976 for "flowing gas" and to October 1, 1977 for "new gas." The court below affirmed this provision at least partially on the assumption that amounts available from the forgiven "refunds" somehow compensated for any error. Again, the "disadvantaged" producers were ignored.

Even with interim escalations, these rigid, inflexible freezes violate Section 4 of the Natural Gas Act. Findings prerequisite to valid moratoria on filings under Section 4, emphasized in *Permian* and *Austral*, as to expected stability of future costs and as to expected revenue requirements have not been made. There is no record evidence supporting projections of anything to 1976 or 1977; and there are no findings connecting these moratoria, with or without escalations in area ceiling rates, to projections of future incidence of costs, to timing of rising costs and inflation, or to producers' required access to Section 4 to obtain rate increases during the seven years the Commission-prescribed area rates would be effective.

These "moratoria" on producer filings under Section 4 simply are plucked "from the blue" and unlawfully bar required access to protective rate increases under Section

4. Amounts of refunds made available to a few producers under the refund foregiveness formulae cannot compensate other producers who are not benefitted by those provisions.

IV. The Commission, by only eleven lines in its opinion, imposed mandatory "minimum" charges by pipeline companies to producers for transportation of liquids and liquefiable hydrocarbons.

These transportation charges were already the subject of a separate rulemaking proceeding before the Commission and were interjected by provisions of the "settlement" proposal. Subsequently, the general order prescribing these transportation charges for all areas was set aside in *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1283 (D.C. Cir. 1973), on grounds that the Commission has no jurisdiction over transportation of liquids, and that the charges for transportation of liquefiable hydrocarbons were adopted without compliance with hearing procedures and "substantial evidence" required under the Natural Gas Act.

The court below erred in refusing to remand issues raised by these charges for further Commission consideration. The pipeline transportation charges adopted in this case were allegedly based upon pipeline "studies" including costs and return claims already disallowed or reduced by the Commission in pipeline rate dockets, and upon compression costs and other expenses *not* incurred in rendering these services in Southern Louisiana. No adequate findings have been made on these presentations or on the cross-examination of two witnesses presenting the pipeline "studies."

The pipelines have not sustained their burden of supporting these charges under Section 4 and 5 of the Act; the eleven lines on this subject in the Commission opinion do not even purport to be complete findings of fact on the evidence on this issue; and the conclusion to ac-

cept the transportation charges set out in the "settlement" proposal of these rates is unlawful. These charges for Southern Louisiana should be reconsidered by the Commission, along with the reconsideration of such charges for all areas now required by the District of Columbia Circuit's opinion.

V. No adequate provision has been made to cover increases in producer's payments to royalty owners.

In Southern Louisiana, the royalty interest exceeds 15% of the total volume of natural gas delivered, and the Commission computed "costs" on the assumption that under its assertion of jurisdiction over the royalty interest, payments by producers to the royalty owners will not exceed the Commission-prescribed area rate ceilings. However, that assertion of Commission jurisdiction has been reversed by a decision that is now final. *Mobil Oil Corporation* v. *Federal Power Commission*, 463 F.2d 256 (D.C. Cir. 1971), cert. den. 406 U.S. 976 (1972).

An adjustment thus must be provided in area rates fixed for Southern Louisiana natural gas producers: (1) a producer could be required to pay royalty owners on the basis of the "area rate" as "market value," even if the producer's filed rates have been and are lower under contracts or Commission orders; therefore, an allowance thus must be included for producers to cover any such differentials; or (2) if royalty payments rise above area rate ceilings to current "market values," producers must be allowed to adjust their rates upward to cover such payments in excess of the payments assumed in the Commission opinions on review. Otherwise, allowances for operating costs, returns, and exploration and development expenses simply will be eroded by the payments to royalty owners.

Therefore, because of the reversal of the claim of Commission jurisdiction over royalty payments, the Com-

mission erred in failing to provide for coverage of this drain on producers' revenues when producers are required to pay royalty on bases exceeding the producers' rates effective under Section 4 of the Act.

VI. None of the requirements of *Hope*, *Permian*, or *Austral* have been heeded in this case, to the detriment of producers and consumers of natural gas. Southern Louisiana is too critical a supply area to permit such a process of "fixing" producer area rates that are supposed to maintain adequate supplies of natural gas at reasonable, lawful rates for most of the decade of the 1970s. The Commission should be required to reconsider all elements of this rate structure, independently of the taint of the "settlement" proposal, on the record adduced before its Hearing Examiner.

ARGUMENT

Questions raised by Mobil as to treatment of refunds, related maximum area rate levels, and provisions for escalations of those rates, present conflicts between the holdings below as to the Commission's Southern Louisiana area rate decision and the decision as to the Commission's Texas Gulf Coast area rate decision in *Texas Gulf Coast Area Natural Gas Rate Cases: Public Service Commission for the State of New York v. Federal Power Commission*, 487, F.2d 1043 (D.C. Cir. 1973). For reasons shown in this brief, Mobil submits that the court below erred in approving this area rate structure, and that the District of Columbia Circuit has correctly concluded that these formulae for regulation of natural gas producers violate the standards of Sections 4 and 5 of the Natural Gas Act, prohibiting unjust, unduly discriminatory, and unduly preferential rates and rate structures.

Other questions raised by Mobil as to moratoria, charges for transportation of liquids and liquefiable hydrocarbons, and coverage of royalty payments do not involve such a conflict among the circuits, but arise because of Commission action that conflict with this Court's constructions of Sections 4 and 5 of the Natural Gas Act in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), and *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944). On each of these issues, the action of the Commission deprives Mobil, and others similarly situated, of "just and reasonable" area rates, not only in Southern Louisiana, but also in other producing areas where the same structure has been imposed on the basis of precedent established by the Southern Louisiana decision.

On each of these issues, Mobil therefore seeks reversal of the Court of Appeals and a remand to the Federal Power Commission for reconsideration and modification of its opinions and orders to comport with the requirements of the Natural Gas Act.

I. Provisions of the Commission's Orders Covering Treatment of Producer Refunds and Providing for Contingent Escalation of Area Ceiling Rates Are Unjust, Unduly Discriminatory, and Unduly Preferential; Violate Sections 4 and 5 of the Natural Gas Act; and Must Be Set Aside

The issues discussed in this section of the argument relate to Sections 3 and 8 of the UDC "settlement" proposal approved by the Commission which are set forth at II A. 681-683 and II A. 691-699; and which are discussed in the Commission opinions at II A. 592-593, II A. 599-601, II A. 648-649, and II A. 652-654, and in the Court of Appeals' opinion at App. C to Pet., pp. 39-51.

A. *The Nature of the Formula For Treatment of Producer Refunds Was Disregarded by the Court of Appeals*

Pertinent provisions of the Commission's opinion include

(1) prescription of new ceiling rates for computing producer refund liabilities for the period prior to August 1, 1971, in lieu of the rates prescribed by the Commission's earlier Opinion No. 546 which was issued in 1968 and reviewed in the *Austral* case;

(2) a novel formula for forgiveness of refund liability on an individual company basis by allowance of a credit of 1 cent per Mcf for new natural gas reserves dedicated by the company in the Southern Louisiana area;

(3) a related provision under which new natural gas reserves so counted by individual producers to discharge their refund obligations are *excluded* from counting the natural gas reserves required to "earn," on an industry basis, contingent escalations in flowing gas ceiling rates for all area producer sellers if certain specified quantities of new natural gas reserves are dedicated in the future (II A. 648-649, 652-654).

The producer refund liabilities involved exceeded $376,000,000 through 1970 under the rates fixed by Opinion No. 546, which was reviewed in *Austral;* and $150,000,000 under the new ceiling rates substituted for past periods in the Commission's Opinion No. 598, now on review (see Ex. 104, Sched. 91-5, Sheet 2 of 2, set forth at V A. 268e). However, these producer refund liabilities are not uniformly distributed over the area producing industry, but are owed by a relatively small number of producers who have collected the highest rates above just and reasonable rates in the past. The record thus shows that only a few companies now account for

substantial portions of the total refunds due from producers in the entire area (V A. 268e);

	Refund Liabilities	
	Under Op. 546:	Under Op. 598:
Shell Oil Company	$ 36.5 million	$14.7 million
Standard Oil Company of California	$ 42.2 million	$19.2 million
The Superior Oil Company	$ 59.6 million	$28.6 million
	$138.3 million	$62.5 million

The record further shows that twenty-three producers account for over 82% of the refunds owed, with the remainder spread over the hundreds of other regulated producers in Southern Louisiana (V A. 268e). Under the UDC "settlement" adopted by the Commission, none of these amounts need be refunded, but the producers owing them would be permitted to use such funds in their operations and to avoid cash refunds by receiving credit for new natural gas reserves dedicated.

Before the Commission and the Court of Appeals, Mobil objected to these provisions of the UDC "settlement" on grounds, *inter alia*, that the rates and rate design unlawfully discriminate in favor of a few producers who owe the bulk of the refunds and who have collected the highest rates above just and reasonable rates in the past, and against producers whose past rates have been at lower levels under Commission guidelines and orders and who have made cash refunds (discussed in more detail, *infra*).

The Commission agreed that "one group is in effect rewarded for relative intransigence" and "achieve a favored revenue position," and that the "logic" of Mobil's "position cannot be assailed" (II A. 600). Nevertheless, the Commission ignored the "logic" because "broader acceptability of the UDC proposal with the distributor group impels us to act as we do" (II A. 601).

The Court of Appeals did not assess the questions raised by this rate structure against the substantive standards of Sections 4 and 5 of the Natural Gas Act. Instead, that court apparently treated all issues as questions of "substantial evidence" only (App. C to Pet., pp. 5, 30); declined to "reject an administrative decision merely because one producer's piece of cake is iced and another's is not" (App. C. to Pet., p. 45); and held adoption of this structure to be a matter of administrative discretion" (App. C to Pet., p. 49).

This falls far short of the review of the rate structure and of impact and consequences upon the industry called for in *Permian* (390 U.S. at 769-770, 799), required under Sections 4 and 5 of the Act, and exemplified by the analysis by the District of Columbia Circuit in *Texas Gulf Coast Area Rate Cases, supra.* Indeed, the "iced-cake" analogy does not cover the nature of a "scheme," as the Commission itself characterized it (II A. 601), which in operation, force, and effect, would:

(1) permit the sellers who already collected the highest rates in excess of the just and reasonable rates an added bonus above "flowing gas" rates for the past and for the future;

(2) make available, on a preferential basis, additional capital to be used by these preferred sellers in competitive lease bidding and other unrestricted corporate purposes;

(3) provide a special "incentive" allowance only for these preferred sellers, not made generally available to all area sellers of "flowing gas";

(4) allow the same preferred sellers the full benefit of industry-wide escalations in "flowing gas" ceiling rates earned by dedication of new natural gas reserves by *other* producers, even though the new reserves of these preferred sellers are counted only in reducing their individual refund liabilities;

(5) authorize higher realization from new natural gas reserves for the preferred sellers, substantially above that made available to other producer sellers or new entrants under the "new gas" ceiling rate;

(6) create a preferential pricing system favoring one group of existing producer sellers and discriminating against other existing producer sellers and new entrants competing for leases, natural gas reserves, and sales in the area;

(7) establish a pricing structure providing preference and discrimination in favor of existing natural gas buyers and against new entrants on the buyers' side competing for new natural gas reserves;

(8) force all area producer sellers, in effect, to absorb the impact of the preferred companies' refund liabilities through lower realization from flowing gas and new gas and through the obligation to "earn" escalations in ceiling rates for "the industry," including the preferred sellers, while these preferred sellers use their new natural gas reserves to discharge individual company refund liabilities.

Neither this Court nor any other authority encouraging "settlements" ever authorized a rate structure so fraught with illegalities. Contrary to the conclusions below, the true nature of these provisions for treatment of producer refunds, related ceiling rate levels, and related "contingent escalations" of "flowing gas" ceiling rates, thus should have been measured against this impact and these consequences upon the natural gas producing industry in the area and under the standards of Sections 4 and 5 of the Natural Gas Act. The questions so raised cannot be resolved by a head-count of assenting, benefited parties, or by assumptions of unlimited agency "discretion" under statutory standards expressly prohibiting unjust, unduly discriminatory, and unduly preferential rate structures.

B. *The "Settlement" Was Imposed Without Regard For The Southern Louisiana Area Producer Rate Structure Created by Commission Orders and Policies*

Commission errors commenced with attempting to combine producer refund forgiveness, incentives for the producing industry, and modified "flowing gas" rates without regard for the existing producer area rate structure and the dispersal of past incurrence and present existence of producer refund liabilities. Faced with demands that it must accept a "settlement" as a "package," the Commission failed to assess the context in which it acted, its own role in creating the structure upon which this "settlement" would be superimposed, and its duty under Sections 4 and 5 of the Act.[9]

Since 1954, Commission regulation created the existing Southern Louisiana producers' rate structure; and on September 28, 1960, the Commission put into effect (1) its method of regulation of producers' rates on a group basis, and (2) its Statement of General Policy No. 61-1 expressing the "guidelines" for rate increases under Section 4 and rates for new sales the Commission would accept without a "condition" as to initial rate under Section 7 of the Act.[10] The Commission also placed in effect three programs pertinent to questions now presented: (1) encouragement of settlement of contested rate dockets by individual producers by reduction of

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[9] As the Commission conceded, if the decision to accept the UDC "package," including the "refunds" section, had not been made, "the price for new gas might well have been greatly higher" (II A. 870). In the same way, the Commission treated refund-forgiveness as part of the "incentive" in fixing the "flowing gas" rate (II A. 647-648).

[10] For Southern Louisiana, the levels were prescribed and later modified by amendments to the Policy Statement. See *Statement of General Policy No. 61-1*, 24 FPC 818 (1960); *Fourth Amendment to Statement of General Policy No. 61-1*, 26 FPC 661 (1961).

rates to levels at or near the Commission's announced "guideline" levels;[11] (2) acceptance of settlement of Southern Louisiana Section 7 producer cases at levels of 20.625 cents per Mcf onshore and 19.00 cents per Mcf offshore; and (3) determination of "in-line" initial prices for Southern Louisiana producers, after hearings under Section 7, of 20 cents per Mcf offshore and 18.5 cents per Mcf onshore.[12]

Application of these policies resulted in substantial producer refunds, reduction of producer rates to the Commission guidelines, and moratoria on producer rate increases for substantial periods. A large number of the major producers participated in these programs, but a few did not.

For example, between 1960 and October 1, 1968, Mobil entered into a series of settlements approved by the Commission and fully supported by many of the parties now supporting the Commission. Under a company-wide settlement, Mobil refunded to pipelines $12,413,000 and reduced its rates by over $5,000,000 *per annum* (Ex. 98, V A. 252e). For Southern Louisiana sales only, Mobil refunded over $4,000,000 (Ex. 104, Sched. 91-2, Sheet 2 of 4, V A. 261e). Beginning in 1964, Mobil also reduced current and future rates to levels prescribed by the Commission's various "guideline" statements and decisions in effect between 1960 and 1968. Between 1960 and 1968, Mobil's average revenue for jurisdictional Southern Louisiana area natural gas sales thus was near the Commission Section 7 guidelines; and in 1968, Mobil's average revenue for Southern Louisiana area natural gas

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[11] See, *e.g.*, *Socony Mobil Oil Co., Inc.*, 31 FPC 1101 (1964); *Texaco Inc.*, 30 FPC 1631 (1963); *Pan American Petroleum Corp.*, 35 FPC 502 (1966).

[12] See *Continental Oil Co.* (CATCO), 27 FPC 96 (1962); *Placid Oil Co.*, 30 FPC 283 (1963); *United Gas Pipe Line Co.*, 30 FPC 329 (1963); *Union Texas Petroleum*, 32 FPC 254 (1964).

sales was 19.18 cents per Mcf (Ex. 104, Sched. 91-2, Sheet 4 of 4, V A. 262e).

Before the Commission, the record thus showed, in explicit detail, two major, contrasting patterns for Southern Louisiana area producer sellers. In one group are a number of producers like Mobil who followed Commission policies, settled a substantial number of Southern Louisiana dockets between 1960 and 1966, and thereafter filed rates substantially in accord with the Commission "guideline" and "in-line" levels (see, Ex. 104, Sched. 91-2, Sheet 4 of 4, V A. 262e). Another group consists of producers who did not enter into company-wide rate settlements between 1960 and 1968 or other extensive reduction of contested Section 4 and Section 7 rates to Commission "guideline" levels. These producers continued to collect, subject to refund under Section 4(e) of the Act, considerably higher rates year after year for over the past decade (see, Ex. 104, Sched. 91-2, Sheet 4 of 4, Lines 3 and 20, V A. 262e). As a result, on October 1, 1968—the effective date of the Commission's first Southern Louisiana area rate decision which was reviewed in *Austral*—producers' rates in effect in the area varied over a wide range.

Effective October 1, 1968, the Commission opinions reviewed in *Austral* would have required substantial refunds by a few producers, but relatively much smaller amounts by other sellers in the area (see Ex. 104, Sched. 91-3, Sheets 1 of 4, 2 of 4, V A. 263e, 264e). These amounts were in direct relation to (1) the producer's continuous collection of higher rates and amounts subject to refund for over a decade, and (2) the fact that the higher the rates charged by a producer between 1954 and 1968, the higher was the amount of refund liability under the opinions reviewed in *Austral* (see Ex. 99, V A. 253e).

Thereafter, during the process of judicial review in the *Austral* case, the disparity in producer refund liabilities increased. The Commission entered no further order as to producer refunds and stayed all reductions in rates then on file, including the higher rates then being collected subject to refund. However, a moratorium imposed on filing of new rate increases above the then prescribed area rates after October 1, 1968, was *not* stayed. Results therefore were (1) to freeze rates for Mobil and others similarly situated at the levels of approximately 19 to 20 cents per Mcf in effect on October 1, 1968, but (2) to permit other producers to continue to collect, subject to refund, the higher rates they had in effect on October 1, 1968 at levels up to 25 cents per Mcf and averaging 21 and 22 cents per Mcf.

Judicial review of Opinion No. 546 in the *Austral* case resulted in opinions by the Fifth Circuit which left disposition of the stay to the Commission. Nevertheless, the Commission took no action to lift its moratoria on producer rate increases until October 27, 1970. Then, by its Order No. 413 issued in Docket No. R-394, the Commission announced termination of the moratorium on rate increase filings, effective January 10, 1971 (I A. 108-110). This action had no effect on the continued collection of the diverse rates in effect on and after October 1, 1968, but would have permitted *all* producers the right to file new rates, to be collected subject to refund under Section 4, without restriction as to level of rate except by limitations that might exist in producers' contracts with pipeline purchasers.

However, on November 6, 1970, UDC had filed its motion for approval of its proposed settlement, and on December 24, 1970, the Commission amended its Order No. 413 to impose as new limits on permissible producer rate increases under Section 4, the ceiling rates set forth in the UDC proposal (I A. 347-351). The same order

rejected "ab initio" producer rate increases already filed which exceeded the levels in the UDC proposal. The Commission thus rejected filings by Mobil which exceeded the pending, proposed UDC rate levels in advance of any decision on the merits; *but*, at the same time, other producers were allowed to continue to collect rates higher than those in the UDC proposal for each rate schedule under which a higher rate had been in effect on and after October 1, 1968.[13] For example, a producer collecting 25 cents per Mcf on October 1, 1968, was permitted to continue to collect that rate, while Mobil's increases to 24 cents per Mcf were rejected.

The producer refund amounts at issue thus result from Commission policy and orders applicable for over a decade. The refund amounts are *individual* producer liabilities rather than "group" or "industry" responsibilities. These amounts are in essence two funds: (1) amounts collected by producers between June 7, 1954 and October 1, 1968 at levels exceeding the Commission's Southern Louisiana Section 7 "guideline," "in-line," and settlement levels of 20-21.25 cents per Mcf as applied between 1960 and 1968; and (2) additional amounts collected since October 1, 1968 in excess of the Opinion No. 546 area ceiling rates reviewed in *Austral*, based on the rates in effect for each individual producer on October 1, 1968. The record also shows that most of these amounts exist solely because of the higher rates above just and reasonable rates filed and collected by a relatively few producers (see Ex. 99, V A. 253e).

Therefore, to avoid unlawful discrimination and an unlawful rate structure, the nature, cause, existence and dispersion of these obligations necessarily had to be considered prior to any attempt to substitute forgiveness of

[13] This interim order was affirmed in light of its interim, temporary nature in *Mobil Oil Corporation* v. *Federal Power Commission*, 469 F.2d 130 (1972).

these several individual producer liabilities for current or future "industry incentives," area rate escalations, and working capital that otherwise would be made available to the entire producing industry. Errors now exist because the Commission failed to examine the nature and impact of the UDC "settlement" proposal in the context of this producer rate structure and under the applicable standards of the Natural Gas Act.

C. *The Provisions for Treatment of Producer Refunds and for "Contingent Escalations" In "Flowing Gas" Ceiling Rates Violate Standards of Sections 4 and 5 of the Natural Gas Act*

A valid producer area rate structure is not merely a matter of administrative "discretion," as held below. In finding an identical producer area rate structure unlawful in *Texas Gulf Coast Area Natural Gas Rate Cases: Public Service Commission for the State of New York* v. *Federal Power Commission*, 487 F.2d 1043 (D.C. Cir. 1973), the District of Columbia Circuit thus emphasized the statutory touchstone:

> "Section 5(a) of the Act contemplates that area rates should not be 'unjust, unreasonable, unduly discriminatory, or preferential . . .'" It is to avoid such results that the Commission is charged with arriving at 'just and reasonable rates.' In view of this expressed purpose of the Act, there is need for the Commission to be sensitive and responsive to the discriminatory effects of area rate orders." (487 F. 2d at 1074)

By express terms, Section 4 of the Natural Gas Act thus prohibits producer rates which are "not just and reasonable" and "undue preference or advantage," and Section 5(a) of the Act establishes the substantive standard that no "rule, regulation, practice or contract" affecting a rate may be "unjust, unreasonable, unduly discriminatory or preferential." These standards apply to

any producer rates allowed by the Commission, and it cannot impose an unduly discriminatory, unduly preferential rate structure.

In *Permian*, this Court approved the use of group proceedings to fix rates for producers on area bases and departure from regulation by reference to individual producers' costs. *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). Throughout that opinion, however, this Court emphasized the Commission's obligations to design rate structures to avoid undue preference and discrimination and to treat producer sellers within a given area fairly and equitably. This Court thus cited requirements that "maximum rates must be calculated for a regulated class in conformity with pertinent constitutional limitations"; that price control cannot be "arbitrary" or "discriminatory" (390 U.S. at 769-770); and that area rate orders should not produce "arbitrary or unreasonable consequences" (390 U.S. at 799). No suggestion was made that by deliberate, conscious design, the agency could adopt a structure affording special working capital to one group of producers and simultaneously depriving other producers of adequate rates and an equal opportunity to receive adequate revenues.

The "group" or "area" approach was not intended to be a shield for such preference, as pointed out by the District of Columbia Circuit in its *Texas Gulf* opinion:

> "In our view, allowance for experiment is, indeed appropriate, when applied to such matters as the level of price, and the difficulties of relating an incentive in the new gas price to a needed quantity of supply. The pragmatic need for room and time to experiment cannot substitute for reasoned analysis when the rate structure raises a serious problem of discrimination, a result which the statute expressly guards against, and which the Commission has had long experience in enforcing." (487 F.2d at 1075)

This case, however, was the genesis of Commission departure from these statutory commands. At the outset of producer regulation, the Commission had recognized that it had a statutory ". . . responsibility to treat those similarly situated with equality consonant in the premises . . ." *Reef Fields Gasoline Corp.*, 19 FPC 351, 352 (1958). Subsequently, as noted *supra*, the Commission was cautioned to avoid "arbitrary" or "discriminatory" producer area rates and to carefully assess the "consequences" of its decisions, *Permian Basin Area Rate Cases* (390 U.S. at 769-770, 799); and the Courts of Appeals had *required* the Commission to apply its policies as to producer prices and treatment of refunds equitably and without discrimination. *Mesa Petroleum Company* v. *Federal Power Commission*, 441 F.2d 182 (5th Cir. 1971); *Plaquemines Oil and Gas Company* v. *Federal Power Commission*, 450 F.2d 1334 (D.C. Cir. 1971). Indeed, in one of the earlier producer area rate cases, the Ninth Circuit recognized the nature of Commission "discretion" and affirmed a "refund formula" that had been tailor-made *to remove* discrimination against certain producers. *Hugoton-Anadarko Area Rate Case: California* v. *Federal Power Commission*, 466 F.2d 974 (9th Cir. 1972). However, the result here runs counter to all of these constructions of the Act.

Undue preference and discrimination are the result of mixing up individual refund debts of a few producers with current incentives, future escalations, and "percentage" rate reductions for the present and future supposedly made available "equitably" to the entire producing industry. As noted by the District of Columbia Circuit in its *Texas Gulf* opinion:

> "The question of discrimination and anticompetitive effects is not limited solely to a comparison between old producers and new entrants. Since old producers may differ significantly among themselves, in terms

of flowing gas under contract, the incentive provision may also affect the industry structure as to producers already in the market. The shape and extent of this problem should be identified on the record and considered by the Commision on remand." (487 F.2d at 1076)

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"Generally, at least, uniform prices give all producers an equal opportunity to reduce their costs, or improve their efficiency, to maximize their returns. When a rate differential is fixed by federal regulation, without basis in costs, there is a handicap to opportunity that cannot be removed by effort of the disadvantaged producer to enhance efficiency and competitiveness. This is not merely a problem where 'one producer's piece of cake is iced and another's is not.'" (487 F.2d at 1076)

As explained by Mobil's Witness Knapp, the rates, cut-off dates, and divisions proposed for past periods were arbitrarily selected without regard for Commission policy and precedent for the past periods covered (see IV A. 744-745). The proponents of the settlement simply picked rates, dates, and percentages to minimize the refund of obligations of certain producers.

The record before the Commission also showed that the combination of provisions of the UDC "settlement" created a situation in which Mobil and others similarly situated would be compelled (1) to compete unequally for working capital and in lease acquisitions with the preferred producers who owe these refunds, despite the documented history of exactly how those refunds had been accumulated; (2) to assist in earning "contingent" ceiling rate escalations for those producers who owe these refunds, while the "new" natural gas reserve dedications of those same preferred producers do *not* "count" to earn escalations in ceiling rates for Mobil and the rest of the producing industry; and (3) to refund 30.5% of

certain amounts collected after October 1, 1968 even though the same few producers collected and will retain substantially larger amounts at much higher rates on file both before and after October 1, 1968. Specifically,

(1) Even though the "settlement" ostensibly proposed a two-price system available to all producers, the effect of Section 8.2 of the proposal is to provide higher realization for an indeterminate period for producers with the highest refund obligations. This section provides for individual producer retention of amounts due as refunds in return for commitment of new natural gas reserves under specified conditions (II A. 695-697). Obviously, the producers who collected higher than average rates during the 1960's thereby would be permitted higher realizations in the future than producers who collected lower than average rates during the 1960's. Furthermore, if new producers, including producers who have traditionally operated in other areas, wished to enter into exploration in Southern Louisiana, they would do so under a competitive financial disadvantage relative to the existing producers who have large refund obligations. In lease bidding, these conditions would be particularly onerous to new entrants and to existing producers with low refund obligations. Funds retained through refund-forgiveness for the preferred producers would be available for use by them in lease bidding, while no such benefit would be granted to producers who collected low rates in the past or to new entrants in the Southern Louisiana area.

(2) An obvious undue discrimination would result under operation of Section 8 of the "settlement" in conjunction with the provisions for "contingent escalations" in ceiling rates in Section 3.3.2 of the "settlement" under contracts dated prior to October 1, 1968. Timing of these escalations is made dependent upon new reserves committed to interstate sales, but *excluding* new natural

gas reserves committed to satisfy outstanding refund obligations of individual producers. Therefore, some producers would be committing new natural gas reserves to interstate sales solely for their own benefit because of their refund obligations, while other producers with small refund obligations, or none at all, would be committing new natural gas reserves to earn these "contingent" escalations in area ceiling rates for the benefit of *all* producers who have contracts dated prior to October 1, 1968. New entrants with no contracts dated prior to October 1, 1968 would receive no benefit whatsoever from this provision; and this complicated arrangement obviously offers unequal "incentive" to existing producers.

(3) The actual realization allowed by the Commission is highly unequal, as is illustrated by the table set out as Appendix A-1 to this Brief. Under the example there shown, (1) Producers A, B and C each have sales of 200 billion cubic feet per year under contracts eligible for the "contingent" escalations in "flowing gas" rates; (2) Producer D is a new entrant with no prior sales in the Southern Louisiana area; (3) refund obligations are $1 million for Producer A, $10 million for Producer B, $5 million for Producer C, and none for the new Producer D; and (4) Producers A, B and D commit one trillion cubic feet of natural gas each during the next four years, and the total producing industry commits adequate new natural gas reserves to earn the 1.5 cents Mcf contingent escalation in "flowing gas" rates. The results under the UDC proposal would be (1) Producer A obtains the 1.5 cents escalation in ceiling rates for his sales, pockets $1 million owed in refunds, but has contributed only 0.9 trillion cubic feet of natural gas toward the escalation in area ceiling rates; (2) Producer B obtains the 1.5 cents escalation, pockets the $10 million owed in refunds, but has committed no reserves to earn the escalation in area ceiling rates; (3) Producer C obtains the 1.5 cents escalation in ceiling rates for his

flowing gas sales, pays his refund obligation of $5 million out of increased revenues obtained from the escalation in ceiling rates for his gas sales in less than two years, but has no obligation to do so and does not spend any funds for natural gas exploration and development and commits no new natural gas reserves to earn the escalation in the area ceiling rates; and (4) the new entrant, Producer D, does not benefit from the 1.5 cents escalation in the ceiling rate, has no money to pocket in the form of excused "refunds," and yet contributes one trillion cubic feet of new natural gas reserves so that other area producers may benefit from the additional revenue resulting from the 1.5 cents escalation in area ceiling rates.[14] Careful review of the actual working of the "scheme," as illustrated in Appendix A-1 to this Brief, thus shows its preferential, discriminatory impact upon producers.

(4) A highly discriminatory and preferential feature is the unnecessarily complex provision for calculating producer refunds for deliveries of natural gas during the period October 1, 1968 to January 1, 1971 by applying thirty and one-half percent (30.5%) of the difference between (1) revenues for this period based on producer rates in effect prior to October 1, 1970, and (2) rev-

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[14] As this illustration was analyzed by the District of Columbia Circuit in its *Texas Gulf Coast Area decision* (487 F.2d at 1077-1078):

> "To some extent discrimination is inherent in the contingent escalation because it works on an industry basis, rather than on an individual producer basis. But it rubs salt in the wounds for producer A, who makes a full dedication, to know that not only is the same benefit accorded to producer B who makes no dedication whatever, but that an even greater benefit is accorded to producer C, who makes the same dedication as A, merely because his past conduct calls upon him to make equitable restitution.
>
> "Again the refund incentive discriminates against new entrants who, of course, have no refund liability."

enues which would have resulted for this period through the application of producer rates established in the Opinion No. 546 and 546-A which were reviewed in *Austral* (II A. 692-693). During this period, the Commission's moratorium on filing producer rate increases in excess of the Opinion No. 546 and 546-A rates reviewed in *Austral* was in effect; many producers who had reduced rates pursuant to prior Commission orders already were collecting rates several cents lower than other producers (*e.g.*, 20 cents as compared to 25 cents); and this freeze on producers' rates continued under Commission orders until January 10, 1971. Calculation of refunds on a percentage basis under this formula thus imposes a *double* penalty against the producer so collecting the lower rates; he already is at a disadvantage by having collected less than his competitor under Commission orders; and after refunds based on "excess" collections are determined by this percentage reduction, he will still have a lower rate than his competitor. This effect is illustrated by the table set forth at Appendix A-2 to this Brief. As there shown, the producer with the "higher" rate will retain more revenue after the refund "reduction" than the revenue collected by other producers before the refund "reduction" on the percentage basis.

(5) Section 8.2 of the "settlement" has a further disruptive effect on the competitive position of both buyers and sellers in Southern Louisiana. For example, assume that (1) Producer A has a refund obligation to Purchaser X of $5 million, (2) Producer B has no refund obligation, (3) Purchaser Y has small or no refunds due to it under UDC's proposal, and (4) Producer A and B each have 500 Bcf of new natural gas reserves to commit. Under the UDC proposal, Producer A would commit his natural gas reserves to Purchaser X because he will receive not only a rate of 26 cents per Mcf, but also a $5 million reduction in refund liability; and if one-

twentieth of these reserves are produced in the first year, the value of this sale to Producer A in that year would be $11.5 million ($5 million in reduction of refund liability and $6.5 million in natural gas sales revenue at 26¢ per Mcf). However, Producer B would receive only $6.5 million in the first year from natural gas sales revenue. At the same time, the other pipeline, Purchaser Y, would have almost no chance to obtain new natural gas reserves supply from Producer A and may not be able to obtain supplies from Producer B because he must still compete with Purchaser X in negotiations to purchase new natural gas reserves from Producer B.

The UDC "settlement" approved by the Commission thus creates an unnecessary, cumbersome "bonus" system providing a preferential "incentive" for the few producers who owe the greatest refunds; and the burdens of those producers who actually owe refunds for collecting large sums in excess of just and reasonable rates would effectively be spread to those producers who already have collected lower rates and have already made substantial cash refunds.

Whatever some private parties may so agree to, a head-count of beneficiaries is not enough. The standards of Sections 4 and 5 of the Natural Gas Act prohibit undue preference and discrimination and preclude the foisting of this illegal arrangement on the entire natural gas industry. After careful analysis of this scheme, the District of Columbia Circuit thus correctly held in *Texas Gulf Coast Area Natural Gas Rate Cases, supra*:

> "The work-off provision gives an advantage to sellers charging high prices in the past, particularly as a result of Section 4(e) filings which resulted in rates higher than those specified in the permanent certificate, for it lets them work off their refund obligation by dedications, giving them a preference over producers who had a lower potential refund liability

or who had made cash refunds discharging their liability. This is a happenstance and capricious preference which is not accompanied by any justification of reasonableness." (487 F.2d at 1077, footnote omitted)

* * * *

"Courts have traditionally held that there is broad discretion in the Commission to order the payment of refunds."

* * * *

"In this case, however, the Commission seeks to relieve producers from refund obligations, and to the extent it does so it lets stand, without redress, past violations, and it promotes unjust discrimination and anti-competitive effects. It first impetus lies, if anything, in thwarting rather than effectuating the policy behind the Act, as expressed in § 4 as to refund liabilities, and in § 5 as to the prohibition of undue preferences. This is not to say that wherever a potential refund liability exists, that it is mandatory upon the Commission to order payment. At the minimum, however, we would require the Commission 'to look at the backdrop of the practical consequences' of its refund order, *F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145, 155 (1962), and to assess in a diligent manner whether effects prohibited by § 5(a) exist, and if so, whether they are avoidable. As in the case of the contingent escalations, we do not think that the supply shortage or need for capital rationale have been responsive to the asserted problems of discrimination and anti-competitive effects, and this must be cured on remand." (487 F.2d at 1078)

For these reasons, it is not possible to reconcile the Commission's treatment of producer refunds and the provision for "contingent escalations" in area ceiling rates with the standards of Sections 4 and 5 of the Natural Gas Act. In purpose, operation, and impact, they are unlawful and should be set aside.

D. *These Provisions Were Not The Subject of Required Findings of Fact And Are Not Supported By Substantial Evidence*

The court below found these provisions supported by "substantial evidence on the whole record" (App. C to Pet., p. 5), but votes have been substituted for "evidence," and the Commission opinions are devoid of findings upon the evidence addressed to these provisions of the UDC "settlement."

As noted in the Statement of the Case, *supra*, the proposed settlement and related proposal were placed in the evidentiary record by Commission order, rather than through sponsoring witnesses (see I A. 352, 354). Thereafter, no witness appeared to explain the origin, rationale, or expected operation of its terms. The UDC witness appearing in connection with the "settlement" presented only accounting data showing mechanical application of rates to volumes. No witness appeared in connection with Sections 3 and 8 thereof, and the Commission Staff witness who termed the entire UDC proposal "reasonable" had not considered pleadings in opposition (IV A. 768, 775-776); and had given no consideration to impact on individual producers, producers who had settled in the past, or to the questions of discriminatory effect of the UDC proposal (IV A. 793-795).

All evidence concerning Sections 3 and 8 of the UDC "settlement" proposal established the anti-competitive, discriminatory effect. Yet, no findings of fact were made upon the testimony of the two witnesses who concluded the UDC proposal with anti-competitive (IV A. 758-762, IV A. 723-757); no findings were made upon the testimony of the witness specifically addressed to the "*Austral* criteria" calling for higher rates and an "incentive" pricing system available to all producers, including new entrants; and no findings were made as to the existing rate structure, dispersion of rates and producer refund lia-

bilities, and impact reviewed, *supra*. As products of the haste and gloss "impelled" by UDC, the Commission opinions leave the impression that none of this evidence was even before it. Without proper regard for its own responsibilities or of the record before it, the Commission simply placed its imprimatur on the produce negotiated by the distributors, pipelines, and major beneficiaries of the "refund forgiveness" proposal.

On critical issues, the Commission opinion thus presents only conflicting, superficial conclusionary statements. The "logic" of Mobil's position is conceded, and "later" discussion is promised (II A. 598-560); but all that follows is the one-sided discussion of the terms of the UDC proposal (*e.g.*, II A. 652-654). The interrelation of Sections 3 and 8 is nowhere discussed, and "cash refunds," "new entrants," and "concentration," are mentioned without findings of fact upon what the record actually shows. The initial, inexplicit, inconclusive observation was made that "our orders should have an *overall tendency* to be procompetitive" (II A. 629, emphasis supplied); but preference, discrimination, violations of national policy, and record evidence are not covered or analyzed at all. Compare the Commission discussion with the extensive analysis by the District of Columbia Circuit in its *Texas Gulf Area* opinion, cited *supra*.

Proper findings on the record would have shown in more explicit detail the unlawful discriminatory and anti-competitive effect of the UDC proposal. Such conclusions as the Commission did express have no record basis. The Commission further erred in failing to make findings upon the adverse evidence before it. As a result, a substantial, major part of the area rate order is here without required support, and even if otherwise lawful, must be reversed for further consideration on the basis of complete findings based upon the substantial evidence actually in the record. *Colorado-Wy-*

oming Gas Co. v. *FPC*, 324 U.S. 626, 634 (1945); *Minneapolis Gas Co.* v. *FPC*, 294 F.2d 212 (D.C. Cir. 1961); *Public Service Comm'n. of State of N.Y.* v. *FPC*, 436 F.2d 904 (D.C. Cir. 1970).

E. *Lawful Alternatives For Treatment of Producer Refunds and Equitable Preservation of Working Capital Are Available to the Commission*

Mobil, unlike other petitioners here, does not question the Commission's authority to reconsider producer refunds under the express language of the Fifth Circuit's *Austral* opinion. Mobil also does not question the objectives of providing adequate incentives to increase exploration and development or the necessity for steps by the Commission to prevent erosion of producers' working capital. The objectives, however, must be achieved equitably, and the steps must be in compliance with controlling standards of the Natural Gas Act.

The Commission was not "impelled" to accept the UDC proposal. Other alternatives that are equitable and lawful and available. In Commission Opinion No. 586,[15] the Commission so applied an equitable "refund formula" based upon a "composite" of refund percentages under its past orders and policies. See *Jack W. Grigsby*, 32 FPC 529 (1964). In Opinion No. 586, the formula was tailor-made *to remove* discrimination against certain producers, and a similar formula could have been applied here.

In addition, Mobil showed on the record that adequate capital could be made available to the producing industry as a whole, producer refunds minimized, and equity achieved for all producers by according each individual producer an option to permit deductions from current and future individual company revenues until

[15] Affirmed in *Hugoton-Anadarko Area Rate Case: California* v. *FPC*, 466 F.2d 974 (9th Cir. 1972).

the individual company's past liabilities are worked off (Ex. 96, V A. 242e, 245e-246e). Under Mobil's proposal, the refund burdens would be borne independently of future rates for the natural gas producing industry as a whole; no producer need be deprived to cash to make refunds; and current and future incentives would be available to all. For the period prior to October 1, 1968, the higher natural gas rates derived from the Policy Statement and scores of Section 7 orders would be used as new and sustainable refund floors. The "cut-off" of producer refund liability set out in the *Grigsby* formula would be applied in an equitable manner. Those producers who then owed refunds obviously could elect selective reductions in future revenues until their liability to specific purchasers had been discharged. At the same time, current and future rates, including incentive considerations, would be made available *equally*, and without preference, to all producers.

Other options also are available without further extensive proceedings, and could be sustainable on the present record.

In sum, Sections 3 and 8 of the UDC "settlement" adopted by the Commission violate the standards of Sections 4 and 5 of the Act, are unduly discriminatory and preferential, are anti-competitive, and are not supported by substantial evidence or proper findings of fact. The District of Columbia Circuit has correctly concluded in the *Texas Gulf Area Case* that this scheme for producer area rate regulation is unlawful. The court below erred in refusing to set aside these provisions of Commission Opinion No. 598 and accompanying orders.

II. The Maximum Area Rate Ceilings Do Not Provide or Permit "Just and Reasonable" Rates, Particularly For Producers Not Benefitted By The "Refund Credit" Formula

Sections 4 and 5 of the Natural Gas Act also require that all rates shall be "just and reasonable," but that is not the result in this case.

The Commission approved the producer rates embedded in the "package" "settlement" proposal (see II A. 870), and the Court of Appeals described the combination of these maximum rate ceilings and the "refund credit" systems as a "triumvirate" of "incentives" (App. C to Pet., p. 30). Thus, the opinions below make clear that all deficiencies in the producer area rates prescribed for the present and future were treated as somehow compensated by the "working capital" made available under the preferential refund formula for those producers who owe substantial refunds. For producer sellers not receiving such benefits, the area ceiling rates do not comply with standards of Sections 4 and 5, particularly as construed in *Permian* and *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944).

As in earlier decisions, the Commission used the "date of contract" of October 1, 1968 to separate "new gas" and "old" or flowing gas" for purposes of computing costs and revenue requirements and of fixing area rates for natural gas producers. Issues discussed in this section of the Argument thus involve the parts of Commission Opinion No. 598 appearing at II A. 630-642 (New Gas "Costing") and at II A. 643-648 ("Flowing Gas").

A. *The "New Gas" ceiling Rate Is Unreasonably Low and Inadequate*

The Commission adopted the UDC "settlement" proposal of a ceiling of 26 cents per Mcf for natural gas sold by producers under contracts dated on or after October 1, 1968, for both onshore and offshore sales (II A. 643). An escalation in the ceiling rate of 1 cent per Mcf would be permitted on October 1, 1974 (II A. 592), and no other change could occur until after October 1, 1977 (II A. 651-652). For such contracts, these rates thus would be fixed for a period of nine years.

Precepts of *Permian* and *Hope* are violated by these inadequate rates. In arriving at its conclusions, the Commission followed this process:

(1) it first noted four principal "current cost" studies with a range from the Commission Staff's 21.62 cents per Mcf to producers' estimates of 27 to 38 cents per Mcf, and a range of recommended ceiling rates from 24 to 30 cents per Mcf (II A. 631-632);

(2) the Commission then decided to express only a "general range" on the most highly contested questions of cost determination, without resolving the disputed issues (II A. 634-635);

(3) the Commission then found a "zone of reasonableness of rate of return" on rate base of 13 to 16 percent, and that a rate of return of approximately 15 percent on rate base was "supported by evidence" and "just and reasonable" (II A. 636);

(4) as to other "choices" on disputed items, the Commission expressed only a preference for "the lower end of the range of choices" (II A. 636-637), enumerated these *seriatim*, and concluded with the statement that it had set forth "a variable range of costs," and had not

deemed it necessary to quantify "non-cost" elements, since "the just and reasonable rate for new gas does not exceed reasonable costs" (II A. 642); and

(5) after discussion of the need for new supplies and the intrastate price level in Southern Louisiana (II A. 642-643), it simply accepted the 26 cents rate proposed by the proponents of the UDC "settlement" (II A. 643).

By the Commission's own process, this 26 cents per Mcf ceiling rate for "new gas" thus could be, *at best*, only a "bare-bones" cost, with no "non-cost" adjustments and no consideration of adjustments needed to attract capital and to increase commitments for interstate sales in the Southern Louisiana area even though it was *known* already that higher rates were obtainable elsewhere.[16] The Commission therefore obviously correctly stated, in response to a question raised by the Public Service Commission of New York in its application for rehearing, that but for the producer refund forgiveness treatment, " . . . the price for new gas might well have been greatly higher" (II A. 870).

The Commission had made extensive preliminary findings as to the crucial need for industry capital (II A. 623-626), but these finding cannot be reconciled with the inconclusive "findings" preceding the acceptance of UDC's proposed 26 cents ceiling rate for producers'

[16] Before the Court of Appeals, Mobil filed on January 20, 1972, its "Motion And Application of Mobil Oil Corporation for Leave To Adduce Additional Evidence Before Federal Power Commission," which was denied. Nevertheless, this Motion showed data available to the Commission reflected *inter alia*, that the 26 cents rate is *below* current intrastate levels in Southern Louisiana, *below* levels allowed for imports from Canada, and *far below* levels for substitute supplies such as LNG and SNG developed from propane, naphtha, and other commodities. Both the Commission and the court below could have taken notice of the official Commission reports, studies, orders, and decisions cited in that Motion.

sales of "new gas." If "costs" are not actually found, there is *no* adequate basis for a conclusion that an admittedly "cost-based" rate, with no "non-cost adjustments," is "adequate" to cover expenses, capital costs, return, and funds so critically needed for exploration and development. Moreover, the record before the Commission showed that inflation already experienced established that "current costs" on a 1969 basis were substantially understated and already exceeded 26 cents per Mcf (IV A. 817-820, II A. 728-740).

The producer "new gas" rate does not apply to the producers' principal source of present revenues, *i.e.*, revenues from "flowing gas." Nevertheless, it is the indicator of the ceiling on revenues from acreage to be developed, particularly in the offshore areas. In light of the findings of a critical shortage and of national dependence upon Southern Louisiana for natural gas, the Commission's failure to face up to required findings and required ceiling levels is indefensible.

The UDC "settlement" proposal should have been critically appraised against *hard findings* as to the levels, in fact, required, and to be required, in the 1970s for natural gas sales contracts dated after October 1, 1968. In addition, if "capital requirements" mean that under the combination of the "refund forgiveness" formula and the "new gas" rate, a few favored producers are to receive 27 cents per Mcf for "new gas" (26 cents plus the 1 cent "credit" on their refund debts), there is no rational explanation as to why *all* area sellers should not be allowed to receive at least the same 27 cents per Mcf level for their sales of "new gas."

Moreover, if "the need for dramatically increased production from Southern Louisiana" justified "noncost factors" only two years earlier in the *Austral* case,[17] only

[17] *Austral*, 428 F.2d at 426.

the preferential refund "credit" can explain the Commission's conclusions in this case in 1971. This case simply does not present careful review of the new gas rates "in light of supply, demand, and other market forces" (*Austral*, 428 F.2d at 434). A process that was started was aborted by the interjection of the UDC "settlement" proposal, and the Commission then worked backward from that proffered result.

Before the Court of Appeals, the Commission made known that it *had* already completed a study showing that as early as "the first half of 1970" intrastate prices in Southern Louisiana already exceeded 30 cents per Mcf (Brief for the Federal Power Commission below, p. 40, fn. 22). The court was also apprised that the Commission had found it necessary to initiate still another "experimental," "optional" procedure and new "rulemaking" proceedings in its efforts to elicit supply for interstate natural gas sales (see App. C to Pet., pp. 6-7, fn. 3). At the same time, the gist of the defense of the producer "new gas" rates prescribed in this case was that the ceiling was "adequate" in light of the total "package." [18] This means only that for those producers who benefit from the "refund credit" system, there is compensation for the inadequate natural gas rate level, but for others, there is no such compensatory consideration.

Inexplicably, the Court of Appeals did not consider these issues raised as to inadequacy of the producers "new gas" ceiling rate level. Its opinion stated that "no party" directly challenged this "rate as being too low"

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[18] Thus, the defenders of the "settlement" asserted below: "Those parties who challenge this rate as being too low overlook the fact that this is only a portion of the incentive provided by the Commission . . ." (Brief for Producers Humble Oil & Refining Company, *et al.*, below, p. 25).

(App. C to Pet., p. 34). The questions were raised again by petition for rehearing, but the court merely corrected its statement to reflect the challenges, without further expression upon the questions raised (App. B to Pet., pp. 3-4).

Plainly, none of the admonition set out in *Permian* (390 U.S. at 790-791) and in *Austral* (428 F.2d at 441-444) actually was heeded in this case. Therefore, the Commission conclusion to accept the 26 cents per Mcf "new gas" ceiling rate should be reconsidered, and the Commission directed to complete its findings and conclusions independently of the "settlement" proposal, and then to fix an adequate, reasonable, and equitable "new gas" ceiling rate for all Southern Louisiana Area natural gas producers.

B. *The "Flowing Gas" Rate Is Unreasonably Low, Provides an Inadequate Rate of Return, and Is Unsupported by Required Findings or Substantial Evidence*

The Commission also adopted the UDC "settlement" proposal of ceiling rates of 22.375 cents per Mcf onshore and 21.375 cents per Mcf offshore for natural gas to be delivered under contracts dated prior to October 1, 1968 (II A. 642-648). Those determinations also are based on reversible errors.

Controlling tests are plain and spell out specific criteria for fixing valid rates under the Natural Gas Act. In *Permian*, this Court noted that the test of *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), remained "pertinent." In *Permian*, the Court summarized that test:

> "The Court in Hope found appropriate criteria by inquiring whether 'the return to the equity owner [is] commensurate with returns on investments in

> other enterprises having corresponding risks,' and whether the return was 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.'" (390 U.S. at 790-791)

This Court also expressed the duty of a court reviewing an area rate decision to include the determination of " . . . whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the public interests, both existing and foreseeable." (390 U.S. at 792; see also 390 U.S. at 806-808).

These criteria were not correctly applied in this case. No proper determination of producers' revenue requirements was made, and no valid assessment of return requirements for "flowing gas" preceded acceptance of the "end result" proffered by the UDC "settlement" proposal:

1. The Commission actually made *none* of the required findings and conclusions as to costs of "flowing gas" or producers' revenue requirements from this *primary* source of income, either as of 1969 or for the period covered by the area rate order.

In that portion of the opinion devoted to this subject, the Commission first referred to objections to the UDC "settlement" and to the fact that the record included "four flowing gas cost studies" using "mainly 1969 data" (II A. 643-644); next to the significance and importance of flowing gas in generating the cash flow needed "for a heightened exploration and production effort" (II A. 644-645); and then to the differences in the studies in the record (II A. 645-646). The Commission then listed the Staff "recommendation" of a cost of 21.18 cents per Mcf based on a 13% return on rate base, and then referred to objections to the Staff's rec-

ommendations (II A. 646-648). The Commission then "found" the provisions of the UDC settlement proposal to be "just and reasonable," but at *no point* in this discussion is there a *finding* of the level of producers revenue requirements that must be covered by the "flowing gas" ceiling rate.

To adopt the UDC "settlement" proposal, the Commission thus simply leaped from a recital of the record content to the proposed producer rates with none of the required intermediate findings.[19] Even the most minimal required findings of revenue requirements, particularly as emphasized in *Permian* were not made.

2. The rate of return on rate base actually allowed for "flowing gas" rates is inadequate, unreasonably low, and violative of the controlling standards for an adequate, lawful return under the Act, particularly as construed in *Hope* and *Permian, supra.*

In its findings of "current costs," the Commission had found that large producers "earned 13.5 percent on gas alone in 1962," and that "a rate of return of approximately 15 percent, supported by the evidence in this case, is just and reasonable" (II A. 636). However, in its discussion of "flowing gas" costs, it itemized Staff "costs" using 13 percent, and it adopted rates that could *not* permit earning of a return significantly above that level. Yet the return—even for flowing gas—is a "current" item, and there is *no* rationale for using a return even lower than the 1962 level.

Moreover, if 15% is required currently as the Commission found, then this rate of return also must be

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[19] For example, on the basis of its "costs," the Staff had recommended a single flowing gas ceiling rate of 22 cents per Mcf, which is higher than the "settlement" proposal of 21.375 cents per Mcf for the critical offshore area (IV A. 685). Yet, the Commission nowhere discussed the other rate recommendations, let alone reconciling its adoption of the UDC proposal with the recommendations of other parties.

used to fix reasonable, *non-discriminatory* rates for "flow-in gas" sales. Otherwise, the *Hope* tests are not met for sellers of such natural gas, and the ceiling rates violate statutory requirements. The facts also are, as complete findings would have shown, that with an adequate return, a ceiling of at least 24 cents per Mcf was required in 1971 for this category of sales to cover then current costs of flowing gas.

In any event, an inadequate return must be reconsidered, and the Commission directed to make findings on "all relevant facts" upon the issue of rate of return to be allowed for "flowing gas." *Sun Oil Co.* v. *Federal Power Commission*, 445 F. 2d 764, 766 (D.C. Cir. 1971); *State Corp. Comm'n of Kansas* v. *Federal Power Commission*, 206 F.2d 690, 722 (8th Cir. 1953), *cert den.*, 346 U.S. 922 (1954).

3. Revenues *actually* allowed by imposing the UDC "settlement" ceiling rates will not permit earnings to average 13% and only *might* reach the 1969 "cost" levels listed by the Commission Staff.

The record before the Commission showed that average unit revenues from flowing gas could not exceed 21.18 cents per Mcf (Ex. 106, V A. 269e-271e), and because of contract limitations, average revenues could remain below 22 cents per Mcf until 1974 (IV A. 714-716, 809-814). These *actual* figures are in marked contrast to the generalizations in the Commission opinion and show what can be hidden beneath listing of what are but average costs in the first place.

While the Commission can use average costs and some imprecision can be expected, the Commission still must give an "overall assessment" of producer revenues actually expected in something more than "conclusionary findings," and still must assess "the capital actually

available to the industry as a whole." [20] All of the Commission's discussions of need for incentives and availability of capital are meaningless if, as the record indicates, average revenues allowed for "flowing gas" do not cover average costs, now and for the foreseeable future, and a fair return also is not allowed.

4. Actual costs of flowing gas are not covered by the producer rates allowed.

As noted *supra*, the Commission made none of the required findings as to the 1969 level and as to revenue requirements as of the effective date of its order. Increases as a result of inflation also are not recognized, even though 75% of "costs" such as those listed at II A. 647 are "current" and increase with the general economy (see, *e.g.*, IV A. 589-590, IV A. 732-734, 741-743). Moreover, had the Commission made findings upon the costs shown in the record (see, *e.g.*, list of contested items at II A. 645-646), the opinions would show that in adopting the UDC "settlement" rates, the Commission effectively disallowed producer current costs.

For those area producer sellers not provided with extra working capital through the preferential refund-forgiveness scheme, this means that the rates for flowing gas do not cover current revenue requirements. In addition, even with the effect of inflation ignored, these data and the *actual* revenue deficiency, cited *supra*, fully refute any assumption that the provisions of the UDC "settlement" proposal for flowing gas rates are "reasonable," adequate, or sufficient to attract needed capital for producers into what is thereby made a revenue deficiency area.

Words do not create "incentives." The reality of realization *actually* available to *all* area producer sellers does not jibe with the words in the opinions on review. The

[20] *Austral*, 428 F.2d at 432, 435, 437, 441.

producers' "flowing gas" rates do not comport with the controlling standards. Required findings that are the essence of prescription of valid rates were not made. Yet, the opinions below indicate only an assumption that an allowance for exploration and development may have plugged the gaps (App. C to Pet., pp. 31-32), or that *all* area sellers somehow have been compensated by the refund amounts retained by a few area sellers (App. C to Pet., pp. 39-40).

In any event, a "triumvirate" of unequal, inequitable "incentives" does not comport with what is required by Sections 4 and 5 of the Natural Gas Act. The court below erred in affirming without even canvassing the questions of adequate findings and coverage of revenue requirements, including a proper return allowance, as to "flowing gas" rates, particularly for producers not benefitted by the refund formula. The producer ceiling rates, therefore, should be reconsidered by the Commission on the basis of required findings and under the criteria established in *Hope* and *Permian*.

C. *Guidelines for Valid Producer Area Rates Have Been Violated to the Detriment of Both Producers and Ultimate Consumers*

In this case, the Commission allowed itself to be "impelled" into acceptance of a proposal that does not measure up to criteria for lawful area rates for producers. Current and future producer area rates would be traded away for limited, selective relief from individual refund obligations, detailed *supra*. The immediate losers are other natural gas producers deprived of adequate area rates, but the ultimate losers would be the ultimate consumers of natural gas dependent upon the Southern Louisiana supply area.

An FPC Staff study of national gas supply and demand released on February 25, 1972 was "noticed" and

cited by the court below (App. C to Pet., pp. 24-27). That study projected unsatisfied consumer demand soaring to 9 trillion cubic feet per year in 1980, now only six years hence. At the same time, the Commission has already found that the rate levels set out in the "settlement" are far below what is required to increase interstate supplies. The reality of this situation and the benefits to consumers *if* adequate rates were allowed for *all* producers in Southern Louisiana were thus noted as early as January 13, 1972, by Commissioner Rush Moody, Jr.:[21]

> "With regard to supply, it provides no incentive for the gas industry to explore and develop natural gas reserves to certificate some limited terms sales at 35 cents per mcf, nor, I am sure, did the Commission intend it as such. However, if the Commission is going to allow 'emergency' gas to be used for business as usual on a pipeline except on peak days, there is no justification—and indeed it is discriminatory—to compel some producers to sell 'business as usual' gas at 26 cents[3] while others receive 35 cents. If any new gas is justified for 'business as usual' at 35 cents per mcf, then all new gas is so justified. The resulting price incentive might well in a relatively short time obviate all temporary expedients facing the Commission, such as curtailment cases, and emergency purchasing of gas.[3] Opinion No. 598, Southern Louisiana Area Rate Proceeding."

The results of the area rates prescribed in this case already are a known failure. Despite the assumptions in the "settlement" and in the Commission's opinion that this rate structure would suffice to increase supplies available to interstate purchasers in the Southern Louisiana Area (II A. 642-643), the failure of the "incentives" was known fully even before this case was decided by

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[21] (Dissenting Statement, *Harvey Broyles, Docket No. CI71-878*, 47 FPC 84, 86-87 (1972)).

the Court of Appeals. No significant volumes have been committed by contracts containing the initial prices permitted by Opinion No. 598. Thus, the Court of Appeals noted that the Commission has been required to resort to stop-gap "emergency" action, to construct "optional procedures" for case-by-case exceptions outside the area rate framework, and to initiate still more "rulemaking" efforts (see App. C to Pet., pp. 52, 59). In addition, on a "case-by-case" basis outside of the area rate framework, the Commission is issuing certificates to authorize new sales in the Southern Louisiana Area at initial rates of 45 cents per Mcf on the basis of findings that *as of 1971*, the nationwide "cost of finding and producing gas is in the range of 38-48¢ per Mcf, before production taxes . . ." *Belco Petroleum Company, et al.*, (Opinion No. 659-A, July 20, 1973), 50 FPC —— (mimeo. ed., p. 32).

All of this would have been, and would be, wholly unnecessary *if* an adequate area rate structure were prescribed for *all* producers in the Southern Louisiana Area. This can be done today by a Commission decision on the record, without the blinding compulsion and pressure generated by the UDC "settlement" proposal.

Hope and *Permian* do not permit the Commission to so avoid statutory responsibilities to fix adequate producer rates and to maintain an adequate natural gas supply, or to substitute a plebiscite of parties for the record and findings that must support Commission-prescribed rates under Sections 4 and 5 of the Act. In this case, obsession with the limited issue of refund-forgiveness for certain producers blinded the Commission to its own responsibility for *all* producers and for *all* ultimate consumers. Only reversal of the Commission's abdication now can preclude further erosion of the supply situation and adverse "end results" for all dependent upon the Southern Louisiana Area for their natural gas supplies.

Hope and *Permian* commanded, in details cited *supra*, responsible Commission action. The producers' "new gas" rate and "flowing gas" rate therefore should be reconsidered and modified by Commission compliance with the guidelines in those opinions of this Court. The twin, interrelated objectives of adequate supplies at reasonable rates require a remand to the Commission for this purpose.

III. Provisions For Moratoria on Filing Rate Increases Cannot Be Supported By Treatment of Refunds, and Violate This Court's Holding in *Permian* That Moratoria Must Be Supported By Findings As To Future "Stability of Costs" And Revenue Requirements

The court below approved the imposition of moratoria on rate increases extending for five and six years from the effective date of the Commission decision. The court did so by assuming inequities of this provision were offset by the extra working capital allowed under the "refund-forgiveness" formula (App. C to Pet., pp. 51-52). However, the moratoria similarly violate Section 4 of the Natural Gas Act, as construed in *Permian*.

In *Permian*, this Court emphasized that express, specific findings are required to justify a moratorium on access to Section 4 of the Act (390 U.S. at 771-782); and in *Austral*, the Fifth Circuit had emphasized that "substantial evidence," such as a finding that costs would remain "stable," must support such "encroachment" on the salutary procedures contemplated by Section 4 of the Act (428 F.2d at 430).

Any moratorium bars access to filing and seeking "just and reasonable" rates under Section 4 of the Act and *precludes* Commission continuous examination of producer area rates in light of changing economic and supply conditions. Prior to imposition, some rational projection and analysis therefore obviously are essential.

Yet, here there is no support whatsoever for the duration of more than half a decade adopted by the Commission. No witness appeared to support the provisions, and evidence of other witnesses was *against* such a lengthy moratorium on rate increases in a period of rising costs, volatile economic changes, and unmet demand (see, *e.g.*, IV A. 743-745, IV A. 778-779, IV A. 820).

In this case, the moratoria on rate filings adopted by the Commission were copied from the "settlement" proposal and extend to October 1, 1976 for contracts dated prior to October 1, 1968, and to October 1, 1977 for contracts dated on or after October 1, 1968. These prohibitions on access to Section 4 of the Act by producers are covered by only five lines in the opinion (II A. 651-652). These moratoria obviously are not supported by required findings of fact or substantial evidence, and impose unlawful bars to "just and reasonable" producer rates, even with escalations in the interim.

Mobil's witness Knapp showed that a moratorium not exceeding three years from 1971, combined with *adequate* ceiling rates, would have afforded time for Commission review and *timely* adjustment of an area rate structure (IV A. 743-744). Other witnesses emphasized need for *continuous* Commission assessment of, and response to, changing conditions in supply, demand, the economy, and rates in Southern Louisiana (see, *e.g.*, the witness Foster, (III A. 200-215).

The record was replete with criticism of any Commission practice that could be "inflexible," "unresponsive" to changing economic conditions, freezing prices for too long, and so on (*e.g.*, III A. 216-231). No economist or other qualified witness endorsed the UDC proposition that accurate projections can be made for three-quarters

of the 1970s decade to so fix producers' rates for this critically important area and then to freeze those rates.[22]

In contrast, *Permian* and *Austral* emphasized that a Commission-imposed moratorium on producer rate filings under Section 4 must be supported by findings as to assumed "stability" of future costs and economic conditions. Yet, virtually all cost data in this record are for 1969; all conceded that a period of rising costs was and is ahead; and most parties concede substantial increases in industry expenditures for exploration and development are required during the 1970s (see, *e.g.*, III A. 173-194). Moreover, many components of the cost of "flowing" gas are "current" items which increase with rising costs and inflation.[23] Thus *no* finding could be made that the 1969 test-year costs in this record, or the costs for any vintage, would remain "stable" during the 1970s. All comparisons and trends in the record pointed to exactly the opposite conclusion, and any long-term freeze on producer revenues for existing vintages could only lead to a worsening supply situation, particularly with rising costs in the 1970s.

Aside from denying producers' future "just and reasonable" rates, such a freeze cannot be reasonably related

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[22] With respect to any attempt to project producer revenues for a long future term, the witness Gody thus stated that she made no attempt because ". . . for a period looking, whatever, seven or eight years into the future, I think would not be a very useful exercise" (R. 7691). Staff witness Engel also had made "no study" of the "situation" beyond 1975 (IV A. 778-779).

[23] In the list appearing at II A. 647, these include the "production cost" items of test-year cash expenses, earnings requirements considered in fixing the return percentage, E&D expense, gathering cost, regulatory expense, and production taxes. Production of any vintage obviously has "current" expenses that change over time, including particularly salaries, wages, and cost of maintenance and repairs. The Commission also recognized that "flowing gas" ". . . should bear a part of the responsibility for assuring a cash flow to meet the needs for a heightened exploration and production effort." (II A. 645).

to the present supply situation or to what can be expected for the near-term future. The Commission Staff witness Engel correctly acknowledged the necessity for continuous Commission review of the drilling effort, capital requirements, and results (see IV A. 680-681, IV A. 778-780); and other witnesses and the *Austral* and *Permian* opinions made the same points. Yet, none of this has any real meaning if the Commission, by hasty approval of unsupported proposals such as those advanced by a "settlement," can foreclose any realistic response in the future by review and adjustment of Southern Louisiana area rates for producers. To the contrary, any such straitjacket for the future Commission, as well as the natural gas industry, can be only counter-productive.

The five lines in the Commission opinion addressed to the critical question of these moratoria on rate filings under Section 4 for more than half of the decade of the 1970s plainly are inadequate (II A. 651-652). Moreover, the Court of Appeals' affirmance does not rest upon assessment of validity of the "findings" or supporting "substantial evidence." Instead, the court leaned once more on assumed off-setting "compensation" by the "refund forgiveness" granted for the favored producers, and upon the assumption that other required relief can flow from *other* actions in *other* proceedings which are themselves subject to current attack on judicial review under Section 19(b) of the Act (App. C to Pet., pp. 52, 59).

Permian obviously required far more from the Commission. *Permian* also requires court affirmance or reversal on the basis of the content of the agency opinion then before the court. Grounds not expressed by the agency cannot be drawn anew and added by a reviewing court. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156 (1962); *Securities and Exchange Commission* v. *Chenery Corporation*, 332 U.S. 194 (1947).

The moratoria on rate filings under Section 4 of the Natural Gas Act, thus also tied by the Commission and the court below to the issues of unduly discriminatory and preferential treatment of producer refunds, therefore should be set aside.

IV. Commission Orders As To Pipelines' Mandatory Minimum Charges for Transportation of Liquids and Liquefiable Hydrocarbons Have Been Reversed By the District of Columbia Circuit And Were Erroneously Affirmed Below

As part of its approval of the UDC "settlement" agreement, the Commission imposed on producers new mandatory minimum charges to be collected by pipelines for transportation of liquids and liquefiable hydrocarbons (II A. 650-651, II A. 688-689).[24]

The transportation by pipelines of liquids and liquefiable hydrocarbons in the Southern Louisiana Area generally is for varying distances from offshore platforms or onshore wellheads to processing plants where extraction of liquids occurs. Such charges are revenues to the pipelines and reductions in the realization of producers. Such charges heretofore have been fixed by contract-by-contract negotiation between the producer and the pipeline transporter, subject to Commission review in certificate dockets under Section 7 of the Natural Gas Act.

Since February 5, 1968, the question whether the Commission should fix a mandatory "minimum" rate for these charges on a nationwide-basis had been pending in Commission Docket No. R-338, a separate general rulemaking proceeding. On January 31, 1972, the Commission issued its Order No. 449 in this general rulemaking docket prescribing such mandatory minimum rates on a national

[24] The new minimum charges are 0.02 cents per Mcf per mile (or 2 cents per Mcf per 100 miles) for liquefiable hydrocarbons and "related fuel," and 20 cents per barrel for liquids (II A. 688-689).

basis, applicable to all areas *including* Southern Louisiana. This Order No. 449 thus superseded the provisions in the Southern Louisiana opinion before the Fifth Circuit, but the charges prescribed were identical to those set forth in the "settlement" proposal in the instant case. Thereafter, on July 11, 1973, the Court of Appeals for the District of Columbia Circuit set aside Order No. 449 on grounds (1) that the Commission has *no* jurisdiction over the rates for transportation of liquids, (2) that the procedures used to fix the charges for liquefiable hydrocarbons violated hearing requirements of the Natural Gas Act, and (3) that the "evidentiary" basis for Order No. 449 was defective as a result. *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973). The opinion and judgment in that case are now final.

In the instant case, the issues of jurisdiction and "hearing" requirements pending in the general rulemaking docket were not decided by the Fifth Circuit. However, the questions of validity of findings and "substantial evidence" supporting the charges in the Southern Louisiana opinion were before the Fifth Circuit. Mobil also raised questions of propriety of imposition of the charges collaterally in view of the earlier pendency of the issues of jurisdiction and of the levels of such charges in the Commission's general rulemaking docket applicable to all areas. Mobil sought a remand of this part of Opinion No. 598, but the questions so raised were not discussed by the Court of Appeals.

On these questions, the court below discussed only the question of evidentiary support and concluded that the charges had a "substantial evidentiary basis" (App. C to Pet., p. 57). The question of propriety of inclusion of such provisions in the Commission's area rate opinion in this case, in light of the issues in the other pending

docket and in light of the issuance of the generally applicable, superseding Order No. 449, were not discussed.

The ultimate result reached in this part of the opinion below thus is at odds with the result reached on July 11, 1973, by the Court of Appeals for the District of Columbia Circuit. These minimum charges for transportation are unlawful and should be set aside, and the Commission should reconsider all of the questions so raised in light of the opinion of the District of Columbia Circuit.

In the instant case, Mobil objected to the sudden interjection of the issue and to the inadequate record basis for the proposed charges, particularly in view of the prior pending general rulemaking proceeding in which the charges were at issue. Nevertheless, in eleven lines of its opinion, the Commission adopted the UDC proposal. The Commission recognized "certain difficulties in approving the provision," and that the charges were already the subject of the pending separate rulemaking docket. However, without specific findings, the Commission stated that testimony presented by the pipelines "amply supports the agreed level in the settlement proposal" and approved the provision (II A. 650-651). Yet, such "transportation charges" by the pipelines were not adopted by lawful procedures applicable to pipelines' rates and were *not* supported by required findings of fact or by substantial evidence.

Since these transportation charges by pipelines to producers were being treated as "jurisdictional" and an open docket existed for the purpose of considering minimum levels, the pipelines should have been required to justify their proposed new mandatory minimum charges in that docket in accordance with Section 4 of the Natural Gas Act and the Regulations applicable to pipelines' rate increases. All other rates subject to Commission

jurisdiction must be so justified, but these requirements were not met in the instant case.

The Commission also made no findings upon evidence submitted by Mobil establishing that the variations in the distances, costs, and volumes involved in the transportation of liquids and liquefiable hydrocarbons are such that no reasonable "composite" can be applied; the varying transportation charges should be left to negotiation between the producer and the pipeline in the first instance; and the Commission then should review such charges in passing on specific applications filed under Section 7 of the Act (IV A. 754-755).

Beyond this, the charges adopted are not supported by the evidence in the record. Only two witnesses appeared for the Pipeline Purchaser Group. The witness Anderson submitted a "study" of the average *national* system-wide cost for seven pipelines "operating" in Southern Louisiana purporting to support an area charge of 2 cents per Mcf per 100 miles for liquefiable hydrocarbons (IV A. 642-663). The witness Moye submitted a formula to support the pipelines' proposed minimum rate of 20 cents per barrel for transportation of liquid hydrocarbons (IV A. 609-619, IV A. 664-673). Had the Commission made required findings of fact, the opinions now here would show that the witness Moye correctly stated that because of the many variables involved, "no single formula can be used to determine an appropriate charge which should be assigned to the transportation of liquids in all situations" (IV A. 611). Moreover, the opinion would show that the transportation "cost" studies purportedly supporting the proposed minimum rates for transportation services in Southern Louisiana were, *inter alia.*

(1) based on various *national* or *company*-wide rate cases of only seven of the pipelines operating in South-

ern Louisiana, omitting some of the older, lower "cost" lines in this area; cover a hodge-podge of test periods instead of a single year; include claims for rates of return, depreciation rates, and various other cost items that were still in dispute in pipeline rate cases and not passed on by the Commission (IV A. 650-652, 657-663); include pipelines' claimed costs which have been reduced in "settlements" or otherwise disallowed in pipeline rate case orders issued even before the Commission decision in the instant case; [25]

(2) heavily increased by inclusion of pipelines' system expenses for compression outside of the Southern Louisiana Area (IV A. 653-657), even though in the Southern Louisiana area, *producers* "perform the compression function at offshore platforms with few exceptions" (II A. 754); *and* on the two pipeline offshore systems used for study by the witness Moye, there are *no* compression facilities (IV A. 672-673); and

(3) designed to require producers to pay on a "composite" basis for widely varying hauls, even though the only *two* area systems studied showed maximum hauls varying from 38 miles on one system and to over 104 miles on the other (IV A. 666-667).

Proper, required findings thus would have shown that these essentially "local" charges would be based on a myriad of national pipeline costs, with the inequity of the recommendation further illustrated by the fact that under the formula used by the witness Moye, the charge

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[25] By orders both before and after the closing of the record, the Commission thus had disallowed substantial "cost" claims of the pipelines in the rate filings upon which the Anderson-Moye "studies" were based. See, *e.g.*, *Trunkline Gas Co.*, 41 FPC 172 (1969); *Texas Gas Transmission Corp.*, 44 FPC 112 (1970); *Texas Eastern Transmission Corp.*, 45 FPC 487 (1971); *Natural Gas Pipeline Co.*, 45 FPC 534 (1971). See also discussion of this use of inflated data in *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973).

for transporting a barrel of liquids would be the same on the 38-mile system as on the 104-mile system. Moreover, if the "studies" used were adjusted to reflect reductions for costs disallowed, lower rates of return, and depreciation rates allowable under Commission orders in pipeline rate cases, the results would have been lower than the mandatory minimum rates the Commission copied from the "settlement."

Yet, charges to producers of millions of dollars over more than a decade were erroneously fixed by the strained, conclusionary eleven lines in the Commission opinion. These mandatory minimum rates are not based on evidence required to justify such rates under Section 4 of the Act; the "findings" are incomplete and ignore the preponderance of evidence showing fatal defects in the only two presentations in support of these minimum rates; and *no* "substantial evidence" supports imposition of these pipelines' mandatory minimum rates to reduce revenues for producers in the Southern Louisiana area. In addition, the District of Columbia Circuit has correctly concluded that charges for transportation of liquids are not subject to Commission jurisdiction under the Natural Gas Act.

The District of Columbia Circuit correctly remanded the Commission's "general" order imposing these charges. *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973). The Fifth Circuit erred in accepting them in this case. These provisions of the Commission's orders should be set aside, and the Commission should be required to reconsider the question of these charges for Southern Louisiana in connection with general reconsideration of such charges now required by the opinion of the District of Columbia Circuit.

V. The Commission Erred In Refusing To Provide For Adjustment of Producers' Area Rates To Compensate For Producers' Payments Of Royalty On Bases Higher Than Commission-prescribed Rates

The Commission's position in this case on the question of an adequate "royalty adjustment clause" is the same as that taken by it in other producer area rate cases, *i.e.*, no such clause is required. However, this question now is critical in all Commission area rate decisions, and omission of such a clause can operate to deprive producers of "just and reasonable" rates under Section 4 of the Natural Gas Act.

In Southern Louisiana, the percentage of producers' revenues that must be paid to royalty owners exceeds 15% (II A. 640, n. 124). However, in computing "new gas" costs, the Commission simply assumed that the amount of the payment is "derivative," *i.e.*, the payment can be determined by applying this percentage to the totals of producers' other costs (see table at II A. 638 and II A. 640). Similarly, the "flowing gas" rates rest upon computations of past "test-year" producers' costs which do not include a separate computation of the amount of royalty payments and which rest upon the unexpressed assumption that payments to royalty owners will be simply a percentage of producers' revenues under the Commission-prescribed area rates (see II A. 646-648). The Commission relied upon these "cost" bases to adopt both the producers' "new gas" and "flowing gas" rates set out in the UDC "settlement" and refused to include in its rate structure a clause providing for adjustment of the base area rates where producers do *not* pay royalties on these assumptions, but are required to pay royalties on the basis of "market value" or other

bases higher than producer rates prescribed by the Commission.[26]

Originally, the method of computation used by the Commission in this and other producer area rate decisions was based on the Commission's assumptions that (1) it had jurisdiction over the royalty interest, and (2) its area rate orders, rather than lease provisions, established the "value" used to compute royalty payments. However, these assumptions were laid to rest in *Mobil Oil Corporation* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. den.*, 406 U.S. 976 (1972). There, the court held that the Commission had no jurisdiction over royalty payments; that the producer area rates do not fix ceilings on such payments; and that royalty owners can maintain collateral suits to recover gas royalty payments based on alleged "current market values" exceeding such producer area rates.

The Commission, however, persists in acting as though none of this has happened. Yet, if 15% or more of producer's revenues must be paid out to royalty owners, and those payments are made on bases exceeding the Commission's assumptions, all of the Commission's other assumptions are knocked awry. If the producer area rate is 26 cents per Mcf but royalties must be paid on the basis of 45 cents per Mcf or higher "values," the revenue squeeze is obvious. Funds that the Commission assumes will be available to the producers to cover operating costs, to cover return requirements, and to finance exploration and development simply will evap-

[26] Generally, the amount of the royalty payment can be said to be controlled by two principal figures; (1) percentage, such as 16%, set forth in a lease agreement, which is applied to volumes sold; and (2) a cents per Mcf figure, which may be the producer's own "proceeds," a "market value," or other figure called for by the lease agreement. Multiplication of the figures establishes the amount of the producers' payment to the owner of the royalty. See discussion in *J. M. Huber Corp.* v. *Denman*, 367 F.2d 104 (5th Cir. 1966).

orate in the higher payments to royalty owners. Here, the Commission thus prescribed maximum ceiling rates for producers for past periods and for future periods extending to 1976 and 1977 on the basis of obsolete, erroneous assumptions, and without regard to this impact.

In the more recent Commission Docket No. AR70-1, Mobil demonstrated that far more than a "hypothetical" problem now exists. There, Mobil advised that the State of Texas has filed an Original Petition in the District Court of Travis County, Texas, 53rd Judicial District against Mobil, claiming that the State of Texas,

> ". . . is entitled to receive the 'Market Price' for its royalty at the time of the sale."

and

> ". . . that the State of Texas, as a royalty owner is not limited to any regulated ceiling prices as promulgated by the Federal Power Commission . . . "

The Commission has been advised that other efforts to obtain such royalty payments are being made, and that producers' revenues in all areas are similarly threatened. However, the Commission errs in ignoring that producers are now facing such claims for payment of royalty on "market values" which are substantially above the Commission-prescribed producer area rate ceilings.

The Commission's refusal to face this issue also is at odds with its theory of prescribing area rates to cover producer "costs." A part of this theory of rate-making is to cover current expenses and those which can be anticipated for the future, and, where possible, to provide for adjustments for increases not within the control of the regulated entity. As these principles apply in producer area rate-making, the royalty payment is a recognized legitimate "cost" item, and this Court indicated in its *Permian* opinion that such payments are

to be recoverable through producer area rates. Thus, under the Commission's own theory of establishing "just and reasonable" rates for natural gas producers under Sections 4 and 5 of the Act, provision for an adjustment must be provided. Otherwise, the standard is not met.

Below, Mobil urged the Commission to prescribe a clause permitting an adjustment if, as, and when, a producer *is* required to make royalty payments on "value" bases exceeding the rates the Commission is permitting the producer to collect under the Act. The adjustment would not be made except when such events occur, and the result would be a simple dollar-for-dollar pass-through, protecting the revenues the Commission assumes the producer will have available for all other purposes, including exploration and development. The clause is simple; the need for it is known; and the legitimacy of such a provision under Sections 4 and 5 of the Act cannot be questioned.

The Commission has erred in basing its conclusions on this issue on an assumption of jurisdiction over royalty payments that has been reversed by a judicial opinion that is now final. The Commission further errs in refusing to include an appropriate protective clause in its producer area rate orders and should be required to reconsider the question on remand.

VI. *Hope, Permian, Austral,* and the Public Interest In Adequate Supplies of Natural Gas At Reasonable, Lawful Rates Require Remand and Further Commission Consideration of This Case

The Commission's responsibilities to producers and to all consumer interests affected by its orders were not discharged in this case. After December 14, 1970 when the UDC "settlement" was ordered into the evidentiary record (I A. 352, 354), procedural fairness was discarded in favor of preferential advantage to the "settle-

ment" proponents. From that date forward, more than twenty-five years of construction of substantive standards of the Act were ignored in this case.

Under *Hope*, a lawful return must "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed" (*Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944)); and under constructions by this Court and the Eighth and District of Columbia Circuits, there must be complete and adequate findings of fact as to how the return was arrived at and as to *what it is*.[27] Yet, for the producer flowing gas rates, there are no such findings at all, as shown *supra*.

Specific admonitions in *Permian* also have been ignored:

(1) The Commission was told that it is "obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection . . ." (390 U.S. at 791); but has not done so at "each step" here, particularly by ignoring the unduly discriminatory and preferential impact of the UDC "settlement" proposal, adversely affecting area producers, new entrants, and, ultimately, all consumers dependent upon the Southern Louisiana area;

(2) The Commission was told that it must see to it that "each of the order's essential elements is supported by substantial evidence" (390 U.S. at 792); but here, there are vast gaps;

(3) The Commission was told to indicate "fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment

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[27] *Colorado-Wyoming Gas Co.* v. *FPC*, 324 U.S. 626 (1945); *State Corp. Comm'm. of Kansas* v. *FPC*, 206 F.2d 690 (8th Cir. 1953); *Sun Oil Co.* v. *FPC*, 445 F.2d 764 (D.C. Cir. 1971). See also *Permian*, 390 U.S. at 792, 806-808.

of the consequences of its orders for the character and future development of the industry" (390 U.S. at 792); but here, no such full and careful findings or conclusions appear in the orders on review;

(4) The Commission was warned that it would be expected "hereafter" to "indicate more precisely the formulae by which it intends to proceed" (390 U.S. at 800); but here, there is less, not more, indication and precision;

(5) The Commission was told that it should "reconcile" its "general observations with the specific terms of its rate structure" (390 U.S. at 813 n. 97); but here, it has not done so; and

(6) The Commission was warned that as its "experience with area rate regulation lengthens," the Commission would be expected to treat questions of revenues actually allowed and "consequences" of its area rate structures "more precisely and efficaciously" (390 U.S. at 822); but here, even the "precision" found in *Permian* is missing.

The earlier teaching of the Fifth Circuit in the *Austral* case likewise was unheeded:

(1) The Commission was told that moratoria on rate filings under Section 4 of the Act must be "factually supportable," "reasonable," and based upon "substantial evidence" and conclusions as to future "stable" or "declining" costs (428 F.2d at 430-431); but those imposed here, extending seven and eight years from the 1969 "test year," are not so supported;

(2) The Commission was told that it must evaluate "each rate set against policies as broad as the Natural Gas Act itself," including the purpose of "maintenance of adequate service for the consumer" (428 F.2d at 435); but no such evaluation of "each rate" appears here; and

(3) The Commission was told that it must assess the effect of Commission orders on the degree of concentration and industry competition (428 F.2d at 442); but here, only the most scant, conclusionary statements are made, and no findings on the underlying evidence appear in the opinions.

More than another chorus of "whistling in the dark" thus was expected in this case (see *Austral*, 428 F.2d at 444). Nevertheless, the UDC "settlement" proposal was interjected to override the developing record upon which a lawful decision could have been made.

Controlling precedent of *Hope*, *Permian*, and *Austral* still require such a decision, particularly where natural gas producer rates for the nation's primary source of gas supply are being fixed for three-quarters of a decade. Interests of producers and of ultimate consumers in an adequate supply of natural gas thus require that the orders on review be set aside, and the record be reconsidered by the Commission free of the taint and unsupportable and unlawful terms of the UDC "settlement" proposal.

CONCLUSION

For the foregoing reasons, the opinion and judgment of the Court of Appeals should be reversed; provisions of Commission Opinion Nos. 598 and 598-A should be modified on the specific grounds here set forth by Mobil; and this case should be remanded to the Commission for further consideration, modification of the opinions, and issuance of a lawful decision and orders under Sections 4 and 5 of the Natural Gas Act.

Respectfully submitted,

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February 28, 1974

APPENDICES A-1 AND A-2
TO THIS BRIEF

APPENDIX A-1

Illustration of Operation of Sections 3.3 and 8 of UDC Proposal Discussed on Pages 49-50 of this Brief:

Producers	Current Deliveries of Natural Gas Under Contracts dated Prior to 10/1/68	Refund Obligation Under Opinion No. 546	Natural Gas Committed Southern Louisiana Interstate Market 1971-75	Natural Gas Volume Contributed Toward Contingent Escalation	Increased Annual Revenue from 1.5¢ Contingent Escalation	Funds Acquired Thru Refund Forgiveness
A	200 B cuft	$ 1 mm	1 T cuft	.9 T cuft	$3 mm	$ 1 mm
B	"	10 mm	"	0	"	10 mm
C	"	5 mm	0	0	"	0
D	0	0	1 T cuft	1 T cuft	0	0

APPENDIX A-2

Illustration of Effect of Provision In UDC Proposal for Calculating Producer Refunds for Deliveries of Natural Gas During Period From October 1, 1968 to January 1, 1971 by Applying 30.5% to Amounts Collected in Excess of Opinion No. 546 Rates (see Pages 50-51 of this Brief):

Producer	Contract Rate on 10/1/68	Rate In Effect on 10/1/68	Refunds Under Opinion No. 546 1/1/71	Refunds Under UDC Settlement Proposal* 1/1/71	Rate After Making Refunds Under Opinion No. 546	Rate After Making Refunds Under UDC Settlement Proposal
A	24¢	24¢	5.5	1.7¢	18.5¢	22.3¢
B	24	23	4.5	1.4	18.5	21.6
C	24	22	3.5	1.1	18.5	20.9
D	24	21	2.5	0.8	18.5	20.2
E	24	20	1.5	0.5	18.5	19.5

* Obtained by applying 30.5% (rounded) to the cents per Mcf shown under "Refunds Under Opinion No. 546"